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PLEMENTAL REPORT
THE JAPAN-UNITED STATES
ECONOMIC RELATIONS GROUP

Prepared for
the President of the United States
and the Prime Minister of Japan

October 1981

The Japan-United States Economic Relations Group

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The Japan-United States Economic Relations Group

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Foreword

The Japan-United States Economic Relations Group, consisting of private citizens of the two countries, was established by former President Carter and the late Prime Minister Ohira pursuant to a joint communique of May 2, 1979. The activities of the Group have been continued under the current administrations. The purpose of the Group has been to examine factors affecting the long-term bilateral economic relationship and make recommendations to the President and the Prime Minister designed to strengthen it.

The Group's Chairmen are Ambassador Nobuhiko Ushiba, former State Minister for External Economic Affairs, and Ambassador Robert S. Ingersoll, former Deputy Secretary of State. Other Japanese members are Akio Morita, Chairman, Sony Corporation; Kiichi Saeki, Chairman, Nomura Research Institute; and Isamu Yamashita, Chairman, Mitsui Engineering & Shipbuilding Co., Ltd. The other American members are Hugh T. Patrick, Professor of Economics, Yale University; and Edson W. Spencer, Chairman, Honeywell, Inc. Two original members of the Group, A.W. Clausen, former President of the Bank of America and currently President of the World Bank, and Shuzo Muramoto, President of the Dai-Ichi Kangyo Bank, retired from the Group in 1981.

Joint consultations among the United States and Japanese members have taken place on a regular basis since December 1979. The Group was substantially aided by small staff in each country which commissioned background research and developed materials for the Group's consideration.

During the past two years the Group has examined a broad range

of bilateral and multilateral issues affecting Japan-U.S. economic relations. The members and their staffs have consulted with numerous institutions, public and private, and with many individuals in both countries. These consultations have provided a critical contribution to the identification of issues and the development of the Group's recommendations.

The Group's report to the President and the Prime Minister in January 1981 provides a comprehensive description of major issues and contains policy recommendations for the public and private sectors of both countries.

The May 9, 1981 joint communique between President Reagan and Prime Minister Suzuki noted that the Group's January Report "contains recommendations that will contribute to the long-term development of United States-Japan economic relations." The two leaders agreed that their governments "should address the various recommendations for possible implementation." (See Appendix 1)

This supplemental report discusses the comments of the U.S. and Japanese governments and the private sectors on our January Report, reviews some important issues in the two countries' economic relationship, and makes some further recommendations.

This report is the final official activity of the Group. We hope that our work has contributed to a constructive dialogue on issues in our long-term economic relationship. The members of the Group, on an informal basis, will actively participate in further discussions of these issues and encourage the implementation of the Group's recommendations by the private sectors and governments. We hope others will join us in this effort.

Executive Summary

Japan and the United States are the two largest industrial democratic countries. They account for one-third of the world's annual production of goods and services and almost a fifth of its trade. The two countries' almost \$60 billion annual trading relationship is of very substantial mutual benefit to both. The security of each is vital to the security of the other. The continuing close economic, political, and security relationships of these two large countries is not only essential to their own national interests, but also to world peace and prosperity.

The economic relations between Japan and the United States continue to be basically healthy. At the present time there is no highly politically visible on-going sectoral trade problem between them. Japan and the United States, however, cannot afford to be complacent about their relationship. Problems remain such as inadequate consultative mechanisms, mistaken perceptions of each country in the other country, and a tendency for bilateral trade disputes to become highly politicized. The bilateral trade imbalance is currently at record levels and may well continue to widen in coming months, probably stimulating acrimonious debate on the openness of the Japanese market and the adequacy of U.S. export efforts. Difficult bilateral negotiations on agricultural quotas lie ahead, and in the longer-term increased competition in services may raise new and more complicated kinds of trade disputes.

Japan and the United States also face difficult, long-term challenges in strengthening their policies in support of liberalized trade and capital movements, in finding better means of anticipating and resolving bilateral economic disputes, in reducing their vulnerability to energy

supply interruptions, and in improving their collaboration in a variety of ways to protect the international economic system and promote world peace.

I. THE NEED FOR INTERNATIONAL ECONOMIC LEADERSHIP

In January 1981, the Japan-United States Economic Relations Group delivered a comprehensive report to the President and the Prime Minister. This report included recommendations on the two countries' overall relationship, macroeconomic issues, energy issues, industrial and agricultural trade questions, the open or closed nature of the Japanese market, problems of trade law, and the problems of the politicization of economic disputes.

Both governments provided the Group with their comments on these recommendations. A number of private sector organizations and private individuals have done likewise. This supplemental report is designed to stimulate further dialogue on important questions and to elaborate on some issues, such as Alaskan oil sales to Japan, coal trade, and North-South issues, which were only very briefly discussed in the January Report.

The Group reiterates its belief that changing international circumstances require a flexible, comprehensive, and outward-looking U.S.-Japan partnership, attuned to the realities of the altered power relationship between the two countries and encompassing global as well as bilateral economic, political, and security concerns.

The reasons such a partnership is required include:

- growing interdependence which makes the international economic system as a whole more subject to shocks, increases the stake of each country in the world economy, and increases problems of making domestic adjustments to changing patterns of international competition.
- the diffusion of world economic power and military parity between the United States and the U.S.S.R. creating new challenges for which shared international leadership is needed.

An effective Japan-U.S. partnership requires better mechanisms for

consultation between the two governments and improved inter-agency coordination within each government on important policy issues.

- The Group reiterates its support for cabinet level meetings bringing together the heads of core departments and ministries dealing with foreign relations, trade and industry, energy, agriculture, and financial and monetary problems. Sub-cabinet meetings should be held on a regular basis, preferably every six months.
- Intra-governmental jurisdictional battles inhibit effective internal coordination and bilateral consultation. Both governments should seek better means of reducing inter-agency conflict on major policies affecting their relations with each other.

II. UNITED STATES AND JAPANESE TRADE POLICIES

Both countries benefit very substantially from an international system of free trade and capital flows, but these benefits are not well understood by their publics. The two heads of government should play an active and sustained role in promoting the understanding of the publics and policy-makers in the importance of free trade and the harmful effects of protectionism.

On American and Japanese trade policies, the Group states that:

- Japan's voluntary restraints on passenger car exports to the United States should not be a precedent for future settlements of Japan-U.S. trade issues.
- The agreed-upon acceleration of tariff reductions in semi-conductors, if combined with investments by each industry in the other country and access to government research and development and procurement on the basis of equal national treatment, will help strengthen both countries' semi-conductor industries and benefit semi-conductor users.
- The United States has lacked an effective policy of positive adjustment to international competition. The new administration has stated that it will encourage positive adjustments, but

the burden of adjustment will be primarily on private industry. Many U.S. industries need to develop a longer-term and more internationally-oriented perspective.

Japan's market is as open as that of any other industrial country in terms of tariff protection for manufactures. But there remain difficult non-tariff barriers and Japan's agricultural sector is still heavily protected. Japan should continue to liberalize access to its market and work to change foreign perceptions that its market is closed.

- The Group reaffirms its recommendation that Japan create a trade ombudsman's office and suggests this be studied by the Ad Hoc Commission on Administrative Reform.
- The Group urges Japan to continue to increase the visibility of its economic decision-making.
- Foreigners should be specific when making complaints of trade barriers. Both governments should financially support the Trade Study Group which has been identifying specific trade problems and seeking to resolve them.
- Foreign firms must make more determined efforts to enter the Japanese market.

III. POTENTIAL BILATERAL ECONOMIC ISSUES

Some potential bilateral economic problems include Japan's growing merchandise trade surplus with the United States, agricultural trade issues and negotiations, service sector issues, and questions related to capital flows and foreign investments.

Japan's growing trade surplus with the United States during 1981 could lead to political friction between the two countries. It should be borne in mind that:

- Japan's bilateral trade surplus is structural in nature; even the removal of all Japanese trade barriers would not eliminate the surplus.
- countries should not be concerned about bilateral surpluses and deficits in trade or current accounts so long as their overall international payments are in long-term equilibrium.

- countries need not even have a worldwide balance on current account to be in long-term equilibrium since it may be economically efficient to have a surplus or deficit on capital account with a corresponding deficit or surplus on current account.
- the widening Japanese surplus in 1981 appears to reflect a number of cyclical and special factors, such as the appreciation of the dollar, caused in part by high U.S. interest rates. As these factors change, the bilateral imbalance will be reduced from current levels.

On agricultural trade, both countries, their consumers, and their agricultural communities will benefit from more liberalized trade and structural reform of the Japanese agricultural sector.

- Benefits of liberalization come in the form of lower consumer costs, a broader range of foodstuffs, more genuine food security than a single country can provide, and higher national prosperity resulting from an overall more efficient use of economic resources.
- The gap between the international rice price and Japan's domestic rice price has been drastically reduced in the past three years, due to price restraints by the Japanese government. This trend should continue.
- Japan should begin preparing on the domestic level for negotiations with the United States on citrus and beef quotas. There should be no acceleration of negotiations on these items.
- Medium-term supply and purchase commitments between the two governments on agricultural products will not interfere with market conditions and will provide real and symbolic reassurance to Japan that the United States is a dependable supplier of food.

Service industry trade issues, in such areas as banking, insurance, shipping, and computer software, may be more important in the future.

- The two governments should collaborate to generate a better data base on services, develop more sophisticated analyses of

evolving service trade issues, and explore possibilities for international codes on service trade.

- There should be more private sector studies of these issues.
- The aim of the two governments should be to provide the same treatment for private service firms of the other country as they do for their own firms.

Free capital flows are as important to economic efficiency as free trade flows.

- Japan should continue to liberalize capital markets and encourage the internationalization of the yen. Coherent liberalization plans encompassing both domestic and international markets should be developed.
- In the United States, state unitary taxation systems which discourage foreign investment and operate inequitably should be eliminated.
- The United States should remain a leader in maintaining open capital markets.

IV. ENERGY ISSUES

There appears to be growing complacency toward energy problems. Despite reduced imports in both countries and the present surpluses on world petroleum markets, the basic conditions that gave rise to the petroleum shortages remain and changing political or economic developments could bring back a seller's market in petroleum.

- The Group strongly reaffirms its belief that the two governments should take the leadership in initiating international crisis management studies to deal with very severe petroleum shortage situations. Private organizations should also engage in such studies.
- The United States and Japan should exercise leadership in reexamining the adequacy of stockpiling commitments.
- The United States should make Alaskan oil available for export to Japan. The U.S. government should prepare a detailed analysis of the costs and benefits of the current export

restrictions and the effects of lifting them.

Alternative sources of energy, such as nuclear energy and coal are needed to eliminate the vulnerability of the two countries on Middle East petroleum supplies.

- Nuclear energy is a promising source of energy and both governments should encourage its rapid development. The United States should be a reliable and consistent supplier of nuclear fuels and equipment to Japan.
- A number of constraints exist on the expansion of U.S. exports of steam coal to Japan, including the higher price of American coal compared to other suppliers, transportation and storage deficiencies, environmental problems, and uncertainties about future needs in Japan.
- The private sectors of the two countries are strongly encouraged to accelerate the trade in steam coal. There should be expanded information exchanges between interested private parties in both countries.

V. TOWARD A COMPREHENSIVE PARTNERSHIP

The Japan-U.S. relationship involves not only bilateral and reciprocal obligations but also shared responsibilities for the management of the international economic and political order.

- The sharing of global responsibilities does not imply that the two countries can or should have identical policies toward every issue and region, but they should have frequent consultations and aim to maximize their cooperation.
- Each country needs to be cognizant of the interests and sensitivities of the other country and take that into consideration in its own policy-making process even when the issues are not directly bilateral in nature.

The countries of Western Europe share common values and interests with Japan and the United States. Both Japan and the United States should try to maximize Western European participation in

international cooperation at a time when economic problems and intra-EC tensions are encouraging Western Europe to focus more on internal problems. Institutional mechanisms for dealing with serious trade issues between Japan, the United States, and Western Europe need to be reviewed and strengthened.

There has been a high degree of cooperation between Japan and the United States on relations with the U.S.S.R. But there is a tendency for the United States to formulate its Soviet policies without genuine consultation with allies and a tendency for Japan to react to American initiatives rather than seeking to contribute positively to the development of alliance policies. Both countries should seek to overcome these penchants.

On North-South issues, the Group:

- notes the importance of developing countries for both Japan and the United States.
- urges the United States to seek legislative authority to extend its GSP (generalized system of preferences) to developing countries after current authority expires. Japan has already renewed its GSP program for ten years.
- recommends that both countries improve their foreign assistance programs in both qualitative and quantitative terms.
- urges the United States to maintain support for multilateral lending agencies which can leverage relatively small government contributions into substantially larger capital flows through the private capital markets.
- recommends that Japan reevaluate its rapidly growing foreign assistance program to strengthen its overall effectiveness. This review should encompass the quality of assistance, adequacy of program evaluation, best possible means of administering programs, and their public rationale.

Japan has been making steady progress toward clarifying its defense role, strengthening its self-defense capabilities, and assuming a more equitable burden with the United States in attaining comprehensive security, but much remains to be accomplished.

- Japan should seek to fulfill as early as possible the goals of the National Defense Program Outline and to take concrete

steps to alleviating further the financial burden of maintaining U.S. forces in Japan.

- The United States should be careful in presenting security views so as not to endanger the delicate and essentially domestic process of consensus-building in Japan on its defense policies.
- Both countries need to appreciate better the security role the other is already playing in the East Asia region and the world.

CONCLUSION

The Group will cease existence on September 30, 1981. Its work continues to be relevant, with appropriate follow-up by other groups. Many recommendations are addressed to governments and require implementation by the two governments. To ensure follow-up on these recommendations, both governments should retain and utilize inter-agency mechanisms on a regular basis.

Other recommendations require implementation through the private sectors. The Group is encouraged that the Japan-U.S. Businessmen's Conference and its component organizations in the two countries are considering means of implementing the recommendations relevant to business. The members of the Group, as individuals, will work with these organizations and others in this process.

There is a need for a continuing and constructive dialogue on difficult issues of the kind that the Group itself has been engaged in. There is also a need for both governments and their private sectors to continue to monitor the relationship from a longer-term perspective, reviewing trade barriers and issues, assessing general trends, and seeking to identify future issues for more intensive work. We hope both governments and private sector organizations will keep these tasks in mind.

CHAPTER I

The Need for International Economic Leadership

In January 1981, the Group presented a comprehensive report to the President of the United States and the Prime Minister of Japan. Since that time, the members of the Group have been engaged in an ongoing dialogue, on a formal and informal basis, with government officials, as well as corporate leaders, labor, media, and academic representatives in both countries.

The Japanese and American governments established inter-agency task forces to review our analysis and recommendations. On May 13, 1981, the members of the Group met with ranking representatives of the Japanese government's task force to discuss the report. On June 19, the members participated in a similar discussion with senior American government representatives. Both governments also provided us with written comments on our recommendations. The two governments discussed our report at the sub-cabinet consultations in mid-September and issued a press release on the Group's work (See Appendix 2).

During the two years of the Group's activities, the members of the Group have continued an active discussion with elected representatives in both countries. Japanese members have discussed the report with key cabinet members and ranking Diet members. The American members and the Japanese Chairman have testified before the Joint Economic Committee and the House Ways and Means Trade Subcommittee and have discussed the report with ranking Congressional representatives of both parties. Proposed legislation has been introduced by three members of the House Ways and Means Committee encouraging implementation of some of the Group's recommendations.

In the private sector, meetings on the Group's report have been

sponsored by numerous economic organizations and research institutes such as the Japan-U.S. Businessmen's Conference, the Keidanren, the American Chamber of Commerce in Japan, and Japan Society of New York. In Japan, media organizations have given the report extensive coverage and have deepened public dialogue on the report's recommendations.

We are encouraged by the general public and private sector support for our analysis and recommendations for addressing long-term economic issues. Of course, in a few cases, there was disagreement with specific recommendations. In other cases, our recommendations were supported, but the difficulties of translating long-term and general directions into concrete steps for public and private sector implementation were stressed. In both such cases, we believe a continuing dialogue helps to better understand and clarify basic issues as well as to define desirable and feasible means of implementation.

The central purpose of this supplemental report is to contribute to this dialogue and to encourage its continuation after the end of our Group's formal activities. In the following chapters, we will discuss some of the reactions to the more important recommendations in our January Report and comment upon recent developments in Japan-U.S. economic relations, relevant to longer-term directions in the relationship. Finally, this supplemental report elaborates on some issues such as Alaskan oil, coal, and North-South issues, which we did not discuss as fully as we would have liked in the January Report.

THE CHANGING CONTEXT OF THE JAPAN—U.S. RELATIONSHIP

The United States and Japan represent the two largest of the democratic industrialized nations, both in terms of population and in terms of economic size. Their close association in the postwar era has been of very substantial benefit to both countries. We believe that this relationship will become even more important in the last two decades of this century.

This is because the democratic world faces much more significant and difficult challenges, and desperately needs a new kind of multi-lateral leadership to cope with these challenges. This leadership is not confined to Japan and the United States, but these countries will be the

most significant elements in it. If Japan and the United States are able to develop a close working partnership in resolving bilateral issues between them and in meeting challenges arising from the larger international environment around them, they can be a tremendously important force for maintaining and advancing the economic health and political resilience of the free world. A failure to cooperate would have catastrophic results, not only for their own people, but for the world as a whole.

We believe that changing international circumstances leave no alternative to what we called in our January Report “a flexible, comprehensive, and outward-looking partnership, attuned to the realities of the altered power relationship between the two countries and encompassing global as well as bilateral economic, political, and security concerns.”

Let us examine at some length these changed international circumstances because there is some reluctance in both countries to face up fully to their implications, clinging instead to perceptions of a bygone world. These changes — the growth of interdependence, the relative decline of American power, and the increasing complexity and severity of challenges facing the free world — have not appeared suddenly, rather they have been evolving over a number of years.

“Interdependence” is a much over-used word which, nonetheless, remains the best shorthand way of referring to the inter-penetration of domestic and international economies. In the postwar era there has been a continuing process of economic integration, particularly among the advanced countries, reflected in the growth of trade relative to overall economic growth, the phenomenon of the multinational corporation, the liberalization of trade barriers and international capital movements, and the high degree of dependence of all the advanced countries on imported oil. The process of integration has been vital to growth and increased efficiency, but it has come at the cost of economic self-sufficiency and control. National economies have become far more vulnerable to economic conditions outside the boundaries of the state and beyond its control. Concomitantly, for the largest economies, policies once considered to have largely a domestic impact can now have very important repercussions for the world economy and resonate back on the home economies. The recent high interest rates in the United States, designed to fight domestic inflation, is a case in point.

The high level of interdependence has important implications.

First, in a more integrated world economic system, shocks are transmitted much more rapidly throughout the system, heightening its overall vulnerability. In a sense, the world economic system has become similar to a large electric grid where a serious failure or overload in one part can cause a system-wide “blackout.” In contrast, despite the development of GATT and the IMF, economic policymaking remains relatively compartmentalized in nation states. As a consequence, it becomes increasingly imperative that major countries, especially Japan and the United States, consult not only on traditional aspects of international economic interaction, but on domestic aspects of economic policy as well to avoid and deal better with shocks.

Second, the growth of interdependence has increased the stake of each country in the international economic system as a whole, thus creating “national interests” in the continuation of international economic conditions and related political conditions favorable to domestic economic well-being. These interests need to be better recognized in both our countries, and this is an important element in “internationalizing” Japan and the United States.

Third, interdependence creates difficult domestic problems of economic adjustment. Increasing interdependence has accelerated and intensified the dynamic processes of changes in the American, Japanese, and indeed all economies. Technological change, shifts in consumer demand, capital formation, population growth, and the enhancement of labor skills — all create new and expanding industries and produce economic growth, but put pressure on some industries or firms which are adversely affected by these changes. In the international context, these dynamic forces affect the relative competitiveness of every nation’s industries and firms. While an essential ingredient in any company’s competitiveness, both at home and abroad, lies in its management and labor, at broad sectoral levels these changes in opportunity and performance reflect the evolving comparative advantage of each nation’s economy. The overwhelming majority of consumers and producers alike benefit substantially from this dynamic process of growth and trade.

The postwar era has seen the increasing spread of industrialization around the world, from its historic location in Europe and the United States to Japan and, more recently, a number of newly industrializing countries (NICs) such as Korea, Mexico, and Brazil. This changing industrial structure, and the relative competitiveness of a

number of specific industries, have been dramatically affected by the OPEC-induced sharp, rapid rises in oil prices, especially in 1973-74 and 1979-80. Recent examples are the consumer shift from large to small cars in the United States, and the decreased competitiveness of energy-using primary metals processing such as aluminum in Japan.

All these dynamic changes in industrial structure — at home and abroad — mean that some industries are profitable and expand, and others decline. Market forces, if allowed to operate freely, naturally move labor and capital into expanding sectors. However, structural adjustment is more difficult, time-consuming, and costly in declining industries. Often, governments come under considerable political pressure to assist declining industries through subsidies or trade protection. A major responsibility of our two countries is to avoid these temptations, and foster domestic adjustment consistent with changing conditions of international competitiveness.

A second major shift in the structure of the international system has been the relative decline of the United States vis-a-vis the other trilateral countries in economic terms and the relative American decline vis-a-vis the Soviet Union in military terms. In 1960, the U.S. GNP accounted for about 35% of the world's total; by 1980, it was about 24%. Japan's share in the meantime increased from 5% in 1960 to about 11% today. The decline has been particularly traumatic for Americans for whom the balance of payments crises of the past two decades, the awareness of vulnerability to international economic developments for the first time following the 1973-74 oil embargo, and the high inflation, high unemployment and low growth through much of the 1970s stimulated a growing mood of economic nationalism. In this environment, the appeal of protectionism rose, demands for greater "burden-sharing" by "rich allies" became more intense, and support for foreign assistance weakened.

The decline of American weight in the international economic arena has had far-reaching implications. The United States is no longer in a position to provide the level of support it once did, yet it remains by far the largest single economy and its former position cannot be assumed by any other single country. Thus, a collective effort is required, and this presents difficult problems of leadership and coordination at a time when the challenges to the international economic system have become more intense. Secondly, while the relative decline of the United States has created conditions requiring greater collective efforts

on behalf of general system goals, it also weakens American ability to lead those efforts and provides greater incentives for other countries to take independent paths. In the case of Japan, public and elite perceptions have not caught up with Japan's real economic strength, and Japan has not yet been able to formulate an economic or political international role commensurate with its economic size or the global reach of its interests. In Japan, there remains a tendency to respond to American initiatives or advise Americans without presenting real alternatives. Both countries need to be sensitive to the implications of their altered power relationship.

Although American economic strength vis-a-vis that of its allies had significantly declined during the 1960s and 1970s, its technological and economic superiority vis-a-vis the Soviet Union appeared to increase. Nevertheless, because of a proportionately greater Soviet military effort, the U.S.-U.S.S.R. military balance has been shifting in a direction relatively more favorable to the Soviet Union.

In addition to the security issues arising from shifts in the U.S.-Soviet military balance, there is a wide variety of other security concerns in the developing world that are at the same time more significant to the advanced countries and less susceptible to their policy responses. The causes of instability can come from national, ethnic or religious tensions, social and class disputes, lack of established means of leadership succession, and the like — matters which can be exploited for destructive purposes from the outside with a relatively small investment. On the other hand, the preservation of established governments can require considerable cost and, as the Iranian situation demonstrated, outside support for an unpopular government can further exacerbate domestic tensions. When and how to preserve common interests in the developing world and the means of sharing the burdens of these tasks could become a source of considerable controversy between Japan and the United States.

THE REQUIREMENTS OF LEADERSHIP IN THE WORLD

Throughout this report, we have called upon our countries to exercise world leadership in maintaining the international economic and political systems. Our premises are that both countries have a vital stake in these systems and both have the capability to play a critical

role in their preservation, although each may make different kinds of contributions. Specific actions have been recommended in the trade, financial transactions, energy, and foreign assistance fields. In this introductory chapter, it seems appropriate to speak in more general terms about the responsibilities for each country that world leadership entails.

Since the end of World War II, the United States has been the acknowledged leader of the free world. We believe that the United States has carried out its responsibilities in a generally enlightened and constructive manner, providing both for the security of its allies and contributing to the economic betterment of the world community. In recent years, however, the United States has been less consistent in providing leadership, particularly in the economic area. While it continues to adhere to the principles of free trade and has been a major promoter of the MTN, its record is marred by protectionist practices on such products as textiles, steel, footwear, and dairy products. Its foreign assistance contributions have substantially declined as a percentage of its GNP and now rank among the lowest of the advanced countries.

An important cause of the decline of American economic leadership has been the poor performance of the domestic economy. We are encouraged by the emphasis now being placed on reinvigorating the private sector of the American economy, and we believe that these efforts, if successful, will have a very beneficial effect on U.S. international economic leadership. There is a danger, however, that the current preoccupation with the domestic economy will come at the expense of the U.S. international economic role. The American authorities need to consider both the domestic and international dimensions of economic policy in their decision-making. In particular, the U.S. government must continue to resist protectionist pressures and live up to its commitments to the maintenance of the international economic system.

In the military and political area, the United States has continued to play a dominating role, as its leadership in such disparate areas as Middle East peace negotiations and strategic arms limitations reflects. A weakness, however, has been the failure of the United States to genuinely consult with its allies on many issues which do, indeed, significantly affect their interests. The days when allies were asked to share the burden of implementation, but not the responsibilities of

policy formulation are over. The American leadership role will be enhanced if there is a more genuinely multilateral effort to shape alliance policy on military and political issues.

Japan is relatively new to a world leadership role. There is growing recognition in Japan that commensurate with its position as the second largest industrial democracy, the time has come for Japan to share more in the responsibilities and costs of maintaining international peace and an open, multilateral world economic system. Given the peculiar circumstances of both Japan and the United States, it is clear that Japan's leadership can and will best be exercised in the economic sphere, although Japan is and should continue to take on a larger burden for defense of its home islands and surrounding sea areas. In meeting with President Reagan in May 1981, Prime Minister Suzuki stated that "Japan, on its own initiative and in accordance with its Constitution and basic defense policy, will seek to make even greater efforts for improving its defense capabilities in Japanese territories and in its surrounding sea and air space, and for further alleviating the financial burden of U.S. forces in Japan." We welcome this commitment.

Japan has already become a major pillar of the international economic system. Yet the perception of its role lags behind reality, even in Japan and more so in the United States and Europe. Japan should acknowledge more strongly its leadership role and the responsibilities it has undertaken. Japan has already taken many actions, at both the official and private levels, in opening its markets to foreign goods, services, and investments. In exercising its leadership role, however, and given its extraordinary reliance on the benefits of an open international economic system, Japan must take further actions to remove or reduce remaining barriers.

We believe Japan can exercise a particularly important role in assisting developing countries. As we will discuss in chapter V, its foreign assistance program has grown, but still ranks low in qualitative terms. We look toward Japan's expanding leadership in this field.

THE NEED FOR BILATERAL CONSULTATION AND INTERNAL COORDINATION

During our examination of the Japan-U.S. economic relationship, we have become increasingly aware of deficiencies in consultations

between the two governments and in internal coordination within both governments on policy issues affecting their relationship. These deficiencies can be a serious obstacle to the development of a more effective Japan-U.S. partnership.

In our January Report, we recommended there be closer and more regularized consultations between officials of the two governments at all levels – summit, cabinet, sub-cabinet, and working level. Clearly, such consultations would be most intense at the working level, but it is important that cabinet officials be familiar with their counterparts in the other country and sensitive to that country's interests and problems.

Because economic issues almost always involve the jurisdictions of more than one cabinet department or ministry, **we believe that such cabinet meetings should bring together heads of all core departments and ministries dealing with foreign relations, trade and industry, energy, agriculture, and financial and monetary problems. Such meetings should be held soon after there has been a change of government in one of the two countries or whenever important circumstances require it.**

Most cabinet level meetings between Japan and the United States involve only one minister or secretary who is visiting his counterpart in the other country. This can sometimes encourage separate initiatives in Japan-U.S. economic relations about which other ministries and departments are not fully informed and may not fully support.

A series of sub-cabinet meetings were initiated between the two countries several years ago. These meetings have been very irregular; in fact, there have only been three such meetings, the third being held in September 1981. **We believe that sub-cabinet meetings are required much more frequently on a regular basis, preferably every six months as was the original intention when these meetings were initiated.** We are pleased to note that the two governments have agreed to semi-annual sub-cabinet meetings.

Intra-governmental Jurisdictional Disputes

Clearly a major problem in each government is so-called bureaucratic “turf-fighting” as ministries or departments jockey for leadership on particular issues. This often creates confusion in the other government over just whom to discuss a particular issue with and delays

resolution. Jurisdictional fights can, in fact, encourage the politicization of economic issues. Moreover, they divert attention from the substance and toward questions of individual political fortunes and vested bureaucratic interests.

We recommend that inter-agency coordination of main policy issues in both governments should be carefully reexamined by the respective governments with the aim of reducing inter-agency conflict.

Inter-agency coordinating mechanisms should be put into place in both governments which would meet on a regular basis for effective and sustained coordination of policy issues and follow-up between higher level inter-governmental meetings.

CHAPTER II

United States and Japanese Trade Policies

Much of the January Report was devoted to trade and investment issues, including all or parts of chapters on the basic elements of the Japan-U.S. economic relationship, the open or closed nature of the Japanese market, industrial trade issues, agricultural trade issues, and the relationship between economic disputes and political friction. Trade has been at the core of the Japan-U.S. economic relationship, and trade issues, in one form or another, may well be expected to continue to dominate this relationship.

A common thread ran through our recommendations on trade and investment issues — that both nations are best served by the free flow of goods, services, and capital. It seems well to begin, therefore, by reexamining why the Group believes both countries should maintain strong free trade and investment policies at home and work closely together to support what the July 1981 Ottawa Summit Declaration referred to as “the effective operation of an open multilateral trading system as embodied in the GATT.”

THE IMPORTANCE OF FREE TRADE AND THE GATT

Japan, the United States, and other participants in GATT and the IMF benefit very substantially from relatively free international trade and capital flows. The steady dismantling of many of the barriers to free trade and capital movements that existed in the depression and World War II years has been a mainspring of the unprecedented and sustained period of economic growth over much of the postwar

era. As a result of periodic GATT negotiations lowering trade barriers, the growth of world trade has exceeded GNP growth rates, reflecting the benefits of dynamic competition and more efficient international patterns of economic production and exchange.

Until 1970, the importance of the links between trade and growth were so clear that there was a broad consensus within the free world on the value of the liberalized trade. This consensus, however, has been eroding as a result of the numerous economic difficulties of the 1970s, including resource scarcities, reduced rates of innovation and productivity in some countries, persistent inflation, and high unemployment. The international spread of industrialization combined with an acceleration of the impact of changes in domestic and international competitiveness have increased problems of economic adjustment in developed countries. In turn, demands to increase or preserve protection from world market forces have increased in these countries.

Protectionism is no cure to problems of resource scarcity, slower growth, higher inflation, or unemployment; it would only make these problems worse. It is all the more necessary to exploit the economic efficiencies inherent in freer trade and investment flows. These may not come so easily nor the gains be so dramatic as when trade barriers were higher, but the losses from protection could be substantial. Free trade and investment helps in making the most efficient use of such factors of economic production as labor, machinery and equipment, capital, fuels, and technology.

We are very encouraged by the reaffirmation by the Heads of Government at the Ottawa Summit of their support for free trade principles and the international GATT system. They also pledged to:

continue to resist protectionist pressures, since we recognize that any protectionist measure, whether in the form of overt or hidden trade restrictions or in the form of subsidies to prop up declining industries, not only undermines the dynamics of our economies but also, over time, aggravates inflation and unemployment.

It is important that these pledges be firmly and consistently implemented in actual policies to remove remaining barriers to trade and resist new forms of protectionism. The basis of a successful free trade policy in democracies such as Japan and the United States must be broad public understanding of the value of free trade. It is in part

because of the current lack of public understanding that protectionist arguments continue to appeal to some in policymaking organs, such as the bureaucracies and legislatures, of both our countries.

We recommend that the Heads of Government play an active and sustained role in increasing awareness of the public and policymaking groups in both countries of the importance of free trade and the harmful effects of protectionism. The basic relationships between free trade and capital movements, on one hand, and economic efficiency, growth, and employment, on the other, need to be more broadly appreciated.

U.S. AND JAPANESE TRADE POLICIES

As the world's two largest trading countries, Japan and the United States bear a heavy responsibility for preserving and strengthening the world trading system. As Prime Minister Zenko Suzuki stated in May 1981 at the National Press Club in Washington: "Japan and the United States, as two great economic powers of the free world, have the mutual obligation to guard and preserve the free trade system, even at the cost of our own pain." The most basic element of this responsibility is for each to implement its own trade policies in a manner consistent with the principles of liberalized trade and the GATT system. Each country's record falls short of its rhetoric. Two recent developments in the Japan-U.S. trade relations — Japan's voluntary restraints on the export of cars to the United States and the agreement in principle to accelerate tariff reductions for semi-conductors — illustrate inconsistencies in both countries' trade policies.

In January, our Group recommended against the imposition of quotas or other forms of trade restrictions on Japanese automobile imports. The United States International Trade Commission (ITC) had found that imports were not a substantial cause of injury to the American industry. In our judgment, protectionist measures would not have addressed the basic questions the American industry faced, such as the need for capital formation, productivity improvements, and adjustment to production of fuel-efficient cars. At the same time, they would have increased the cost to consumers and limited consumer choice.

From this perspective, we regard the May 1, 1981 measures, under which Japan took to limit passenger car exports to the United States for a three year period as undesirable interference in the market place

and questionable in economic terms. Supporters often justify these measures as politically necessary to diffuse strong pressures in the United States Congress for much stiffer protection, whether or not they made economic sense. In this limited sense, the agreement has diffused the issue at least so far. However, these voluntary restraints should in no way be a precedent for future settlements of Japan-U.S. trade issues for several reasons.

First, they circumvented the established U.S. statutory procedure for providing an industry with import relief only after a finding of injury is made by the ITC. The automobile settlement suggests that an industry with enough political clout can gain protection without being able to prove injury.

Second, they circumvented established GATT trade rules under which import relief measures should be undertaken only on a world-wide rather than selective basis, with compensation provided to affected trading partners. The May 1 measures immediately spawned demands by Canada and several Western European countries for similar bilateral agreements, outside the GATT, for restraints on Japanese automobile exports.

Third, the voluntary restraints tarnished the rhetoric of both the current American administration in favor of free trade and of the Japanese government in support of GATT rules, creating cynicism about the importance these governments really attach to principles they espouse. This in turn spawns other demands for exceptions to these principles.

In contrast, the agreement to accelerate tariff reductions on semiconductor products provides an example of constructive Japanese-U.S. action that will strengthen the international trading system as well as the industries of both countries. In our January Report, we recommended that the tariff cuts agreed in the MTN to be phased in over an eight year period should be accelerated to arrive promptly at an average 4.2% level on both sides, and thereafter the two countries should work as quickly as possible to eliminate tariffs. Since then, the two governments have agreed in principle to arrive at the 4.2% level next year.

Since Japan currently has a higher average level of tariffs on semiconductor products, Japanese producers will lose a margin of protection they would have received under the slower staging of tariff reductions. This can be justified in terms of Japan's strong industry, and it is

the kind of step Japan should take to fulfill its role as a leader of an open trade system.

We believe that the reduction of trade barriers between Japan and the United States in semi-conductors, if combined with investments in each other's industry and access to government research and development and procurement programs on the basis of equal national treatment, will help strengthen both the American and Japanese semi-conductor industries and help consumers.

Both Japan and the United States have more to do in supporting a free world trade system. In our January Report, we pointed out that probably the greatest contribution the United States could make would be to take measures to improve its own economic performance in controlling inflation, increasing productivity, and restoring healthy domestic growth. We are encouraged by the emphasis of the American government on these tasks, but it is too early to measure the effectiveness of current policy prescriptions.

In the past, the United States has lacked an effective policy of "positive adjustment" to international competition, partly through the short-sightedness of excessively domestically-oriented industries and partly because government has tended to protect declining industries through trade protection. We believe an effective policy should neither inhibit advancing industries nor subsidize or protect declining industries.

In this respect, we strongly applaud the July 1981 statement of U.S. Trade Representative, Amb. William E. Brock, before a joint hearing of the Senate Finance and Banking Committees, which gave emphasis to the need for an "effective approach to industrial adjustment problems." Amb. Brock stated:

Import restrictions, subsidies to domestic industries, and other distorting measures should be avoided. A better solution to the problems associated with shifts in competitiveness is to promote positive adjustment of economies by permitting market forces to operate. It will be critical to encourage, through international negotiation, all governments to adopt adjustment policies which do not have trade and investment distorting effects.

This approach to positive adjustment relies on governmental policies to provide a kind of economic climate in which domestic in-

dustries can thrive, including the removal of regulatory obstacles to the operation of market forces. These measures are consistent with our January recommendations regarding industrial trade and productivity. **It should be emphasized that the principal burden of positive adjustment will fall on private industry itself. We have recommended, and want to reemphasize, that while some U.S. companies have been very active internationally, many American industries still need to develop a longer-term and more internationally-oriented perspective.** The current emphasis on annual and even quarterly profit and loss statements tends to discourage longer-range investments and overseas market development programs that can be critical to remaining internationally competitive. In the event of a failure to adjust, industries should not be supported by taxpayers through subsidies or by consumers through trade protection.

THE JAPANESE MARKET

Our January Report discussed at some length the question of whether or not Japan's market is "open" or "closed." We discussed Japan's market specifically, not because we felt that Japan is the only country which limits access to its domestic market (the U.S. market, for example, is protected by tariffs, "Buy America" laws, orderly marketing arrangements, and various cultural barriers), but because in Japan's case the perception of a closed market is especially widespread and enduring.

Our assessment was that Japan has made very substantial progress in opening its market, particularly in terms of tariff protection and quantitative restrictions on manufactures. It will have the lowest average tariff rates on manufactures of any of the advanced industrialized countries by the end of the phasing in of the MTN. Many difficult obstacles remain, however, especially such informal or culturally related barriers as preferences given to domestic goods by government bureaucrats, procurement largely limited to domestic goods by semi-governmental corporations, preference for domestic and company group produced goods by Japanese purchasers, complicated regulations, and the like. Also, while a substantial amount of liberalization has occurred in the agricultural sector, this sector continues to be heavily protected at a high cost to the Japanese taxpayer and consumer. While we recognize

the special political and social adjustment problems associated with agricultural liberalization, agriculture, like manufacturing and services, cannot be expected from the dictates of free trade and the requirement for positive adjustments to international competition. It is not consistent or credible to support free trade in manufactures and maintain high levels of protectionism for farm products, particularly when Japan has a comparative advantage in manufactures and some other countries have a comparative advantage in agriculture. These subjects were discussed at length in the January Report.

Japan has two important tasks ahead of it — one is to continue the actual process of liberalization and the other is the related task of changing foreign perceptions of the Japanese market. The importance of these two tasks for Japan cannot be overstated. As a major beneficiary of an open world trading system, Japan benefits from continued efforts to preserve access to world markets. A collapse of this system would probably affect Japan far more than the United States or the countries of Western Europe, although it would be an economic catastrophe for all three regions. This is because Japan has a less diversified economy and merchandise exports are essential to provide the earnings needed to buy raw materials and foodstuffs simply not available at home and thereby maintain Japan's high standard of living. Japan's stake in free trade is not based on its political and economic relationship with the United States or any other country, but on direct benefits to Japan of economic specialization and efficiency. It is an essential component of Japan's own national interest.

As we pointed out in our chapter in the January Report on Japan's market, equally important, and too rarely recognized in Japan, are the tremendous benefits to the Japanese economy from the infusion of foreign consumer goods, machinery and equipment, services, technology, and capital.

In January, we made a number of recommendations designed to achieve these aims, including the creation of an office of trade ombudsman under the Prime Minister, the development of more public visibility in economic policymaking, and support for the Trade Study Group.

Trade Ombudsman

In recommending the creation of a "government-wide ombudsman for trade and investment issues," we noted the strong domestic orienta-

tion of many of the Japanese ministries now involved in developing and implementing policies which directly or indirectly influence foreign access to the Japanese economy. This impedes the effective coordination of a liberalized trade policy. We stated:

Japan could address trade import problems more effectively if appropriate governmental institutions were created to help resolve inter-agency conflict. These institutions would also be symbolic of Japan's commitment to an open market and open world trading system.

The Japanese government informed us that the ombudsman concept did not fit in neatly with the current administrative structure and will require much more study. The American government did not directly comment on the proposal, but believed the Group had underestimated the effectiveness of the Trade Facilitation Committee (TFC) in resolving trade problems.

In our judgment it is highly desirable that a trade ombudsman office be created in Japan. The central thrust of our recommendation is to establish a structure within the Japanese government which reflects the vital stake Japan has in a free trade system. This structure would not simply respond to complaints from foreign companies, but would initiate a more internationally-oriented trade policy from within. Proposed statutes, regulations, or administrative interpretations which have trade implications might be reviewed by this office prior to their implementation, not after the filing of a formal complaint.

While we believe the Trade Facilitation Committee has been helpful in drawing attention to very specific market access issues, we do not feel it addresses the purpose of our recommendation. The TFC remains largely a bilateral dispute resolution mechanism for company-specific problems. While Japan could establish other such bilateral committees with other principal trading partners, it would be preferable to have a central office for the consideration of trade policy questions as well as company-specific complaints. Individual companies may feel more comfortable approaching such an office than the ministries with specific jurisdiction.

Regarding the administrative feasibility of the trade ombudsman's office, it should be noted that an advisory commission in Japan is currently studying administrative reform. Other ombudsman offices

are being considered. We believe that the concept of a powerful trade ombudsman's office, along the lines we have suggested, should certainly be seriously studied in this administrative reform review.

Public Visibility of Economic Policymaking

In comparison with the American economic policymaking process, that of Japan remains less open. Our concern with this problem led our Group to recommend in our January Report that:

Japan continue to expand the public visibility of its governmental economic decision-making and implementing process and provide for additional opportunities for access to these processes by the private sector.

Consistent with its obligations under the MTN codes and bilateral agreements, Japan has been taking steps to improve access to its economic decision-making mechanisms. In June 1981, for example, the Nippon Telephone and Telegraph held a well-prepared seminar for foreign businessmen explaining NTT's procurement needs and policies. Additional programs like these could be very useful.

The less open nature of Japanese government economic decision-making reinforces perceptions of a closed Japanese market by outsiders. Greater access will help both foreigners and Japanese not part of the informal information network to gain a better understanding of the opportunities in Japan and help clarify perceptions. Clearly, making changes in basic patterns of governmental decision-making is a long-term effort. We hope, however, that Japan will continue to do so, not just in response to international codes and agreements, but in recognition of the tangible domestic benefits from reduced inefficiencies and favoritism now protected by a lack of "transparency" and an improved foreign perception of the openness of the Japanese market. In this respect, we are very encouraged by the following statement of the Second Ad Hoc Commission on Administrative Reform in its July 1981 First Report:

In connection with relations between the administration and the people, as a basic premise, it is of vital importance to heighten the trust of the people toward the administration. We also think it

necessary to promote studies to institutionalize public access to administrative information and establish monitoring and auditing systems, including ombudsmen.

Support for the Trade Study Group

The accurate identification of trade problems and the effective presentation of these to the Japanese government by foreign interests is vital to any resolution of these problems. Foreign firms sometimes have been reluctant to approach the Japanese government on generic industry or specific company-related problems. Frequently, charges that Japan has a "closed" market are made in sweeping terms, without specifics. It is the responsibility of foreign companies to identify specific trade barriers and to bring them to the attention of the Japanese government.

Work of this sort is being done by the Trade Study Group. The TSG has established working level groups of experts from the American business community, the Japanese business community, and American Embassy and Japanese governmental officials to identify, analyze, and urge correction of specific trade problems. The TSG also provides an important opportunity for informal contacts between American and Japanese business and governmental officials to discuss statutory and administrative issues.

Our January Report recommended that the two governments give the TSG their full support, including financial assistance, to make its operations more effective.

In response, the Japanese government informed us that it will continue to participate in the TSG on an inter-ministerial basis and provide limited financial assistance through JETRO. The U.S. government stated that support would be considered through the TFC. Other support may be made available through government-funded market research and the detailing of personnel to the TSG will be studied.

We have been informed that the TSG is establishing subcommittees to monitor MTN implementation, and that a study is being planned of opportunities for expanding American business involvement in Japan, particularly in the service sector.

We hope the TSG will be making periodic progress reports and are pleased to endorse this kind of voluntary effort to tackle day-to-day issues in the economic relationship by those who know most about

them. We reaffirm our recommendation that the two governments and the respective private sectors support the TSG through the allocation of financial and managerial resources. To be truly effective, the TSG needs to be adequately funded and staffed. It also needs full support of the American business community, including the head offices in the United States.

In our January Report, we noted another possibility for identifying trade issues and bringing them to the attention of the Japanese government — the creation of an American organization in Tokyo similar to the Japan Economic Institute (formerly the U.S.-Japan Trade Council) in Washington. Such an organization could help new-to-market American firms in Japan identify trade opportunities and obstacles and serve as an organization to bring U.S. business concerns to the attention of Japanese governmental officials. We continue to believe that while it is the responsibility of the Japanese government to provide equal access to the foreign business community, it must be the responsibility of non-Japanese businessmen to take advantage of the opportunities provided.

CHAPTER III

Potential Bilateral Economic Issues

During the past decade, Japan-U.S. economic relations have been plagued by sectoral trade disputes, such as those involving textiles, steel, citrus and beef, and automobiles. With the settlement of the automobile issue, there is no current politically highly visible sectoral trade problem between the two countries. Japan and the United States, however, cannot afford to be complacent about their relationship. The bilateral trade imbalance is currently at record levels and may well continue to widen in coming months. Difficult bilateral negotiations on agricultural quotas lie ahead, and in the longer-term, increased competition in services may raise new and more complicated kinds of issues. Another area of potential conflict lies in the area of capital markets and direct investment. In this chapter, we will discuss some of these issues.

THE BILATERAL TRADE IMBALANCE

Between any two large, sophisticated, and highly dynamic economies, it is likely that trade disputes will emerge from time to time. When confined to a specific industry, these issues can be important and politically contentious in themselves, but in the case of Japan-U.S. trade, they become even more controversial when the United States has a large global current account deficit or a large bilateral deficit with Japan, especially when Japan has a large global surplus as in 1977-78. This combination, together with continuing perceptions of a closed Japanese market, gives rise to American beliefs that Japan is not

playing the trade game fairly.

Since January, Japan's bilateral merchandise trade surplus has risen to record monthly rates and may well increase from \$9.9 billion in calendar year 1980 to an unprecedented \$13 to \$15 billion this year. There is a serious danger that a record bilateral U.S. trade deficit with Japan, in the context of a generally deteriorating U.S. trade position, will raise public and Congressional cries of Japanese unfairness or threats of retaliation despite the absence of any increased trade barriers in the Japanese market or any specific sectoral trade dispute. For this reason, we believe it important to review certain basic points we made in the January Report about the meaning of merchandise trade and current account balances as well as to examine the causes and significance of the current high levels.

First, as a basic rule, countries should not be particularly concerned about bilateral surplus and deficit positions on merchandise trade and current accounts so long as their overall international positions are in long-term equilibrium. In the case of bilateral Japan-U.S. trade, Japan has had a persistent surplus in its trade in goods and services with the United States since the mid-1960s. The main cause of this trade surplus has been structural — the goods the United States imports match those Japan exports more closely than do American exports match Japanese imports. There are cyclical factors and, at times, special temporary events which affect the size of the trade gap, but studies have indicated that even the removal of all remaining Japanese trade barriers would not result in an elimination of the trade imbalance. Indeed, Japan's surplus has grown despite Japan's steady trade liberalization policies.

A bilateral imbalance of this nature reflects efficiency and patterns of comparative advantage, and it should not be a goal of American policy to artificially seek a bilateral trade balance with Japan. To make a bilateral balance such a goal would be inconsistent with more fundamental policy priorities — controlling inflation, reducing unemployment, and maximizing economic prosperity. It is economically efficient and beneficial to run surpluses with some nations and deficits with others. Americans have come increasingly to recognize this, particularly in 1980 when the U.S. merchandise trade surplus with the European Economic Community was twice the size of the U.S. deficit with Japan (See Table 1). For the United States to seek to eliminate its deficit with Japan or surplus with Europe by government policy would distort pat-

terms of comparative advantage and result in a net loss of economic prosperity for all three regions.

TABLE 1

BILATERAL TRADE BALANCES: U.S., JAPAN, AND EUROPEAN
ECONOMIC COMMUNITY, CALENDAR YEAR 1980

	(Unit: \$ millions)		
	U.S. Exports (FAS)	U.S. Imports (FAS)	Balance
Japan	20,790	30,701	-9,911
EEC	53,679	35,958	+17,721
Total	220,705	240,834	-20,129
	Japan Exports (FOB)	Japan Imports (FOB)	Balance
U.S.	31,351	21,505	+9,846
EEC	16,032	6,719	+9,313
Total	126,736	124,611	+2,125

Second, the fact that Japan imports a high proportion of raw materials and agricultural products from the United States and exports a high proportion of manufactured products does not imply an unequal or dependent economic relationship. It reflects the more narrow Japanese economic base and its resource vulnerabilities. It is one of the strengths of the U.S. economy that it can provide not only sophisticated, high technology goods (such as aircraft), but also is efficient and competitive in agriculture, timber, and some mineral products.

Japan's imports of U.S. manufactured goods have increased more than twice as rapidly as Japan's imports of U.S. agricultural goods and raw materials in the past five years. Japan has pledged to try to continue to encourage the expansion of imports of manufactured goods. In July 1981, for example, Japan's Minister of International Trade and Industry, Rokusuke Tanaka, promised that the Japanese government would "make every possible effort to realize the expansion of the import of manufactured goods." It must be recognized by other countries, however, that Japan can buy manufactured goods only by selling more manufactured goods. It has little else to offer.

Third, even on a worldwide basis, a country need not be in balance on either merchandise trade account or current account to be in long-term equilibrium. The merchandise trade balance measures only the value of goods traded. It does not include "invisibles" such as services,

transportation charges, travel, or investment income, nor does it include governmental transfers or long-term or short-term capital flows. The current account (on a global basis) provides a somewhat more meaningful description of a nation's overall international position than the balance of merchandise trade. In addition to goods, the current account also includes service sector transactions and governmental transfers. It does not, however, include either short or long-term capital movements.

Depending on basic economic circumstances and policies, it may be economically sound for a country to be in a deficit or surplus position on current account and to have a corresponding surplus or deficit on capital transactions. In Japan's case, its high saving rate relative to domestic investment demand suggests that in the long-run Japan is likely to have a net outflow of capital (deficit on capital account) and an excess of exports over imports (surplus on current account). Japanese capital outflows benefit a world that is short of capital. Of course, in the short-run any country can experience cyclical deficits, as Japan did in 1974-75 and in 1979-80.

Fourth, countries should be conscious of the impact of their economies and economic policies on each other. This is particularly true of large economies such as those of the United States and Japan. Japan will have to be sensitive to the problems that its tendency to run trade and current account surpluses have for the United States and the European Economic Community. Similarly, the United States must be cognizant of the effect its economic policies (such as its current tight monetary policies leading to high interest rates) have on the rest of the world economy. These are the kinds of issues on which there need to be frequent and frank consultations between Japanese and American officials.

It is not yet possible to explain precisely the sources of the widening Japanese bilateral trade surplus in 1981, and the relative importance of various causes. Clearly, part reflects Japan's general export successes as its economy has effectively adjusted to the sharp oil price increases of 1979-80. In addition, the temporary slowdown of Japanese economic growth in recent months has retarded increases in Japanese imports from the United States and elsewhere.

A number of other cyclical and special factors are at work as well. Inflation makes all numbers appear larger. Japan's inflation rate is well below that of the United States; this differential tends to make American exports less price competitive and Japan's more so. An important

factor has been the effect of very high interest rates in the United States as monetary policy is being rigorously pursued to combat inflation. High interest rates have attracted funds into the United States, including petrodollars and other monies in or earlier destined for Japan. These capital inflows have strengthened the dollar against the yen and other currencies, making American exports more expensive in world markets and imports cheaper in American market. The full force of the appreciation of the dollar has not yet been fully reflected in the trade statistics.

Many of these factors — U.S. inflation, high U.S. interest rates, a weak yen and strong dollar, and slower Japanese growth rate — will presumably change. As they change, the U.S. bilateral trade deficit with Japan will be reduced from current levels, but it will not disappear. That should be expected and should not be a cause for alarm. For both nations the real issues lie in the overall balance of our respective global payments and in the ability of our respective economies to adjust and grow.

AGRICULTURAL TRADE ISSUES

In the area of agricultural trade, we urged both countries to reduce agricultural protection. We pointed to the high taxpayer and consumer costs of Japan's agricultural protection and recommended that Japan move away from quantitative restrictions and explore measures (such as deficiency payments) which would allow world market prices to be more adequately reflected in domestic support programs. We also urged Japan to restructure its agricultural sector to increase farm size, efficiency, and productivity. To alleviate very real Japanese food security concerns, we recommended that Japan enlarge its inadequate wheat and feedgrain reserves and that the United States and Japan enter into negotiations leading to medium-term supply and purchase arrangements.

No part of our January Report was more controversial in Japan than these recommendations on agricultural trade. In addition to the comments of officials of Ministry of Agriculture, Forestry and Fisheries, we received responses from the National Chamber of Agriculture and from the Japan Fruit Growers Cooperative Association.

Some basic views expressed by Japanese agricultural interests are

the following:

- A strong agricultural sector and rural community are essential to Japan's political, economic, and social stability and development and thereby contribute to the long-term Japan-U.S. relationship.
- Japan is the world's largest importer of agricultural foods, and the best customer of U.S. farm products.
- Further increases in the ratio of imports would lead to the decline of Japan's agricultural sector and worsen the world food situation.
- The basis of food security must be Japan's own domestic agricultural production.

Regarding our specific recommendations, the National Chamber of Agriculture contended that immediately reducing the gap between domestic prices and international prices would be harmful to farmers. The Chamber recommended that policies should aim to keep the gap from increasing in the short-term while allowing for some reduction in the gap in the long-term. The National Chamber also contended that a deficiency payments scheme as an alternative to quotas would be expensive and that it would not be "an effective means of immediately making possible the abolition of import quotas." Agricultural groups generally agreed with the need to increase farm size, but contended that even with larger farms, land-intensive agricultural crops would still not be internationally competitive.

Some of the comments of Japanese agricultural groups reflected a fear that our Group was recommending that Japanese agricultural policies be immediately and drastically changed, causing serious social disruption and economic hardship in Japan's rural community. In our January Report, we stated that the:

implementation of these changes raises some very difficult economic, social, political, and even psychological issues in Japan. Nevertheless, we believe that the changes we have recommended are in Japan's own interests and will be beneficial to Japanese food producers and consumers as well as to Japan-U.S. agricultural trade relations. While recognizing that the steps we have recommended will take time, we strongly urge that the Japanese

government initiate major steps in the directions we have recommended.

We agree that policy changes should be implemented gradually and in a way to minimize social and economic disruption. But, as we stated in January, Japan is now making a much greater effort to protect existing inefficient patterns of agricultural production rather than adjusting to a new more competitive pattern. Japan's policy objectives and goals must be changed in a manner consistent with the principle of positive adjustment, for the good of its national society as well as its trade policy.

The Need for Liberalized Trade in Agriculture

In almost all developed countries, agriculture has asked for and won a special level of protection from international competition. This is true for Japan; it is true of the European Economic Community countries and certain agricultural sectors in the United States.

Agricultural protection, however, is expensive and can be costly in terms of good trade relationships. Other countries' agricultural barriers strengthen the arguments of those in the United States who say that the United States should erect similar barriers around its manufacturing industries.

We believe that our countries can benefit from the liberalization of agricultural trade just as they have from manufacturing trade. These benefits come in the form of lower consumer costs, a broader range of foodstuffs, more genuine food security than a single country can provide, and higher national prosperity resulting from an overall more efficient use of economic resources.

Rice Policy

We believe that if Japan adopts programs of positive adjustment in agriculture, it can develop an agricultural sector which is more productive and better able to compete internationally. Agricultural liberalization does not imply a necessary decline in Japanese agriculture, but it will entail a transformation of Japanese agriculture away from products Japan cannot produce efficiently and towards products which Japan can produce more efficiently.

At the present time, the main obstacle to a stronger program of positive adjustment in the agricultural sector is Japan's rice support program which maintains the price about three times the world market price and generates huge stockpiles of a commodity for which demand is decreasing in Japan. This program consumes approximately 27% of the budget of the Ministry of Agriculture, Forestry and Fisheries of Japan, and basically supports part-time, inefficient farmers. High budgetary expenditures on the rice support program reduces the budget available for agricultural diversification, market research and development, and other programs of positive adjustment. Moreover, high rice support prices and exports of subsidized rice directly and indirectly affect trade relations with the United States and other internationally competitive rice growing countries by replacing some domestic feed-grain imports and cutting into third markets. It is the responsibility of the Japanese government to ensure that domestic support programs do not distort foreign trade patterns.

We are encouraged by the efforts Japan's political leadership have been making to reduce the gap between the international and domestic price of rice in the past few years. Table 2 shows that the gap has decreased from a domestic price 4.24 times the international price in 1978 to 2.78 times the international price in July 1981. We hope this trend will continue.

TABLE 2
A COMPARISON OF DOMESTIC AND INTERNATIONAL RICE PRICE
(Unit: yen/ton)

Year	Domestic Price (A)	International Price (B)	(A)/(B)	Exchange Rate (yen)
1978	318,755	75,058	424	212.03
1979	319,272	69,466	459	219.83
1980	326,571	95,141	343	229.81
July 1981	328,085	117,883	278	228.90

Note: 1. Domestic price is calculated at the government purchased brown rice price converted into that of milled rice.

2. International price is the average of FOB price for Thai rice (10% broken rice).

The figure for 1981 is as of July.

3. Annual exchange rate is calculated by averaging the exchange rate at the beginning of each month.

Beef and Citrus

In January we pointed out that agricultural experts in both the United States and Japan believe that Japan can develop internationally competitive beef and citrus industries. Protectionism, however, has hurt these industries by preserving inefficiencies, discouraging rationalization, and limiting market development.

Japanese citrus producers are opposed to any further liberalization of import quotas. Both governments agreed that the 1978-82 period should be a time of adjustment for Japanese producers. In 1978 the two governments also agreed to further negotiations toward the end of Japan's FY 1982, and the United States expects substantial liberalization.

Citrus and beef quotas have been a symbol of Japanese protectionism, even though citrus and beef would not be major U.S. exports on the same scale as grains if all barriers were removed. It seems likely there will be a difficult negotiation in 1982-83. These negotiations will come at a time of a very high Japanese bilateral trade surplus with the United States. We believe that as in the cases of protection of the U.S. automobile, steel, and color television industries, Japanese protection of beef and citrus should be temporary, and that the industries concerned should take positive programs of adjustment and improvement.

There are some in the United States who have suggested an acceleration of these negotiations. We strongly recommend against such an acceleration. An agreement for a five year period of adjustment was made in 1978, and the Japanese industries are entitled to this time span.

Japan should begin preparing on the domestic level for these negotiations, and both sides should seek to ensure that beef and citrus quotas do not become a highly political issue as they did in 1977 and 1978.

Medium-Term Supply and Purchase Agreements

The U.S. government did not respond favorably to our recommendation for medium-term supply and purchase arrangements. The United States pointed to its record as Japan's most reliable agricultural supplier throughout the 1970s, and noted that the pattern of trade did not change during the period of the "Abe-Butz Gentlemen's Agree-

ment.” The Japanese government regarded our recommendation as feasible, but noted that it needed to give consideration to the position of the supplier government.

The U.S. position reflects a failure to comprehend fully the depth of Japanese fears of food insecurity. Japan depends directly or indirectly for approximately 50% of its caloric intake on imported agricultural products, about the same percentage of dependence the United States had on imported petroleum in the mid-70s, a dependency the United States is still urgently trying to reduce.

In fact, the United States does have an excellent record of supplying agricultural products to Japan. However, the perception of the United States as a reliable supplier was damaged both by the 1973 soybean embargo and the agricultural embargo against the Soviet Union following the Afghanistan invasion. These embargoes are referred to by those in Japan opposed to more agricultural imports to give credibility to the argument that the United States uses food exports as a political weapon.

It is important in strengthening the climate in Japan for an expanded Japan-U.S. agricultural relationship that the United States do everything possible to alleviate Japanese fears of food insecurity. A medium-term arrangement like the “Abe-Butz Agreement” does not interfere with free market forces or require U.S. financial commitments. It provides symbolic and real reassurance to Japan that the United States is committed to being a dependable supplier of food to its best friends and customers.

SERVICE TRADE ISSUES

In our January Report, we noted that trade in services is becoming increasingly important in the Japan-U.S. economic relationship. Traditional service industries such as banking, insurance, transportation, construction, engineering, entertainment, and professional and legal services are expanding in world trade. These industries are being joined by new service industries such as electronic data processing and information services, and exports of management, capital, and technology through franchising and trading companies.

On a bilateral basis, service industry problems may be a source of some friction. In the United States, there has been a sweeping deregula-

tion and structural transformation of the banking industry. With more liberal exchange transactions, U.S. deregulation measures and other international pressures will affect Japan's financial policy, increasing pressures for deregulation and causing difficult problems of adjustment.

Other areas of potential strain in service trade include insurance, computer software and data processing as well as international shipping where increased competition and/or differences in American and Japanese policies may bring trade problems to the surface.

Service trade issues tend to be much more complicated than traditional trade issues involving goods. Services are often regulated by national and (in the United States) by states statutes and regulations which may restrict market entry and competition. Since tariffs cannot easily be applied to services, trade barriers are of the more complex non-tariff kind, also making such concepts as "anti-dumping duties" and "countervailing duties" more difficult to apply. A further complication is that in such areas as civil aviation and telecommunications, governmental or semi-governmental bodies often provide services rather than private industry.

Service sector problems are only beginning to be explored by governments and private sector groups. Current multilateral efforts to address these issues are concentrated in the OECD, where preliminary work seeks to develop an inventory of barriers to trade in services. These barriers may include restrictions on entry of goods essential to performance of services, arbitrary standards or technical requirements, subsidies, differential tax treatment regarding the remittance of royalties, nationalistic government procurement policies, and visa limitations restricting a company's ability to provide services.

We believe that Japan and the United States, as two large economies with relatively sophisticated service industries, can both benefit from expanded global trade and competition in services. Both will also benefit from the establishment of international rules limiting governmental involvement in service trade and establishing fair rules for international competition.

We urge both countries to actively collaborate to generate better data on services, develop more sophisticated analyses of evolving service trade issues, and explore possibilities for international rules or codes governing service trade and means of enforcement.

We also recommended that the private sectors in both countries give careful attention and study to potential service trade issues. Eco-

conomic organizations and research institutes in both countries should strengthen efforts to identify service trade barriers and means of strengthening international competition and efficiency in the service sector.

Finally, we believe that it should be a goal of both governments policy to provide treatment to the private service firms of other countries equal to treatment given its own firms.

CAPITAL AND DIRECT INVESTMENT FLOWS

Free capital flows are as important to economic efficiency as free trade flows. Our Group recommended in our January Report that Japan continue to encourage the internationalization of the yen and liberalization of capital markets.

Liberalization of capital markets is continuing in Japan. As we stated in January, a number of steps have reduced or relaxed legal restrictions and administrative barriers to capital movements over the past decade. These include the 1980 Foreign Exchange and Foreign Trade Control Law under which the control of international capital transactions has been changed from a system where transactions not expressly allowed were prohibited to a system permitting transactions not expressly prohibited. We applaud the thrust of this change and reemphasize our hope that the new system will be administered in a way permitting maximum freedom in international capital flows.

Evidence of Japan's liberalization has been reflected in the growth of petrodollar and other capital flows into Japan. In 1980 alone the inflow of petrodollars from oil-exporting nations was about \$12.5 billion; the total balance outstanding at the end of the year was \$18.5 billion. However, the ability of Japan to attract such foreign funds on a sustained basis will depend upon the capital market and other conditions which make such investments attractive. Government monetary and financial policies in both countries have resulted in the recent gap between very high interest rates in the United States and much lower interest rates in Japan, resulting in capital outflows from Japan.

With liberalization, Japan's financial markets, domestic and foreign are undergoing substantial structural transformation, although not of the sweeping degree or speed now being witnessed in the Amer-

ican financial system. This transition process is fueled by both domestic and international forces; it will probably take some time before all transactions in Japanese short-term and longer-term finances are predominantly market-determined. As Japan both generates increased savings and becomes a more important outlet for petrodollars, it will be desirable to take further steps to increase foreign opportunities for borrowing in yen and for Japanese financial institutions to lend yen-denominated assets to non-residents. For example, Japan should consider the possibility of creating an off-shore market in yen in which Japanese and foreign financial institutions could participate and of encouraging the development of a short-term market in banker's acceptances. A range of innovations such as these would further encourage the liberalization of capital markets and internationalization of the yen.

We recognize the importance and intensity of the debate currently underway in Japan on these matters. As the August 1981 Report of the Committee on the Role of the Postal Savings System comprehensively stated:

The integration of domestic and foreign economies by liberalization of external transactions, the progress of internationalization of finance such as increased inflows and outflows of capital, the greater availability of near-maturity national bonds in the market reflecting the large amounts of national bond issuance, and so on are among the changes in the economic environment which direct the Japanese economy to require interest rate liberalization. . . . In order to deal directly with interest rate liberalization, there is a need to examine concrete steps for it such as an establishment of a forum for deliberation by private sector representatives with knowledge and expertise on the subject.

We strongly recommend that Japanese authorities draft coherent liberalization plans encompassing both domestic and international markets. Internationalization of the yen should be developed within the broader context of the overall international financial system and the evolving financial policies of the United States. Joint studies of the future international financial situation, and on the respective international responsibilities of the United States and Japan as the world's two largest capital markets, should be initiated on both the governmental and private levels. This will enhance Japan-U.S. dialogue and

understanding on financial matters of mutual importance.

The American investment environment has been one of the world's most open in terms of capital transactions and foreign participation. A number of Federal measures including anti-trust statutes, Security Exchanges and Commission regulations, tax policies and regulations affect direct and portfolio investment. These measures are applied on an "equal national treatment" basis; they do not discriminate against foreign firms.

At the state level a number of restrictions and promotion programs distort or influence investment. On the positive side, virtually all states engages in some programs of investment promotion based on tax benefits, infrastructure improvements, zoning and regulatory assistance, and various other measures. Some measures, however, may discourage investment, even though that is not the intent.

For example, a number of Japanese and American multinational firms have complained about the discriminatory impact of so-called "unitary taxation" systems which have been adopted in three states — California, Oregon, and Alaska.

Unitary taxation systems do not discriminate against foreign firms as such, rather they assess the state tax for multinational firms (foreign and domestic) on a percentage of firms' worldwide profits equal to the average percent of worldwide property value, payroll, and sales located in the taxing jurisdiction. Under the California system, a firm operating in California, for example, at no profit would be liable to a tax on its worldwide profits even though all these were derived from sources outside California. On the other hand, a multinational with high California profits but a poor performance elsewhere could escape taxes.

These systems tend to discourage foreign investment in these states because they fail to account for start-up costs. The first years of a new operation are unlikely to be very profitable, and unitary taxation adds an additional cost if the firm is making a worldwide profit.

There is proposed legislation in the State of California and in the Congress which would eliminate this form of taxing. **While there are many sound reasons for terminating unitary taxation systems (for example, they are administratively burdensome and can result in double taxation since they may assess taxes on income derived outside the taxing jurisdiction without any compensating tax writeoff elsewhere), we hope legislators on both the state and the Federal levels will take into consideration their deleterious effects on foreign investments**

and foreign relations.

We are also concerned by the growth in public sentiment in the United States favoring limitations on foreign investment, particularly in real estate. These moves are rarely directed at Japanese investment. We hope, however, that the United States will remain a leader in maintaining open capital markets and protecting the rights of its citizens and foreigners to make the investments of their choice in the United States.

CHAPTER IV

Energy Issues

If trade relations are handled poorly, the Japanese-American partnership could be seriously injured. If energy issues are poorly managed, however, the results could be catastrophic. As the two largest consumers of energy and of crude petroleum on the world market, Japan and the United States are competitors for energy supplies and also have a common, vital interest in securing adequate supplies of reasonably priced energy. In a serious and prolonged supply crisis situation, there would be powerful pressures in each country urging unilateral actions that could be damaging to other consuming countries. If Japan, the United States, and other energy consuming countries can effectively cooperate in the short and long-term in resolving their energy problems, the relationship among them will be greatly strengthened.

Since our January Report was published, we have become deeply concerned about what appears to be growing complacency in both Japan and the United States toward energy supply problems. This complacency reflects a presently much more favorable world energy environment. Conservation and energy substitution policies in much of the industrial world are beginning to show dividends, reducing overall demand for crude petroleum. The figures for Japan and the United States (see Table 3), for example, show very steep declines in consumption in 1980, a fact all the more impressive in the Japanese case since Japan recorded a real GNP growth rate in that year of 4.2%. Crude petroleum prices are now declining, and there are serious strains within the OPEC cartel.

TABLE 3
IMPORT OF CRUDE PETROLEUM
(average daily imports in thousands of barrels)

Time Period	Japan	United States
1979	4,776	6,452
1980	4,283	5,177
1981 (through May)	4,189	4,452
January	3,591	4,790
February	4,533	4,731
March	4,353	4,341
April	4,100 (average)	4,172
May		4,245
June		(no data available)

Sources: *U.S. Department of Energy; Ministry of Finance, Japan*

Despite these developments, there can be no room for complacency. The basic structural facts which caused energy shortages and exorbitant price increases remain as well as the political facts which make a major supply crisis a real possibility. The vast majority of petroleum available for export is supplied by a very few producing countries (many of which can be described as politically fragile), and the industrial world continues to rely to an overwhelming degree on petroleum as an energy source. Moreover, the present "glut" reflects not simply decreased demand in consuming countries, but a relatively generous supply policy by the major exporting country — Saudi Arabia. Should Saudi Arabia change its petroleum export policies because of political change, a Middle East conflict, or a change in the calculation of its economic gains, the current over-supply situation could rapidly disappear. In fact, Saudi Arabia has indicated it may reduce production by 1 million barrels per day. A much stronger economic performance in the United States or Western Europe also could reduce the petroleum surplus.

The present favorable supply and demand conditions, therefore, do not call for complacency. Rather, they present an excellent opportunity for major importing nations to take steps to strengthen their energy positions against any future supply shortfall.

CRISIS MANAGEMENT STUDIES

In our January Report, we described the energy supply situation as a "critical security problem." We recommended a series of measures to deal with this problem including improved bilateral and multilateral consultation, a strengthening of the International Energy Agency (IEA); increased stockpiling, conservation, energy research and development; and greater use of available alternative sources. Recognizing that fundamental changes in energy production and use would require time and that a supply crisis could occur at any time, we urged the Japanese and American governments to take the lead in developing crisis management studies and planning to deal with a possible large-scale energy supply interruption. Crisis management studies would entail the examination of the nature and severity of supply crises that might arise, the kinds of situations that could cause such crises, their economic and political implications for both countries and the world, and the policy responses that would be appropriate for different crisis scenarios.

Our recommendation for crisis management studies and contingency planning received a cool response from both governments. Part of the reason seems to reflect a belief that we were calling for bilateral measures to the exclusion of other countries. That was not our intent. In our January Report, we stated that "the danger of a catastrophic supply interruption is so serious that we believe the governments of Japan and the United States should undertake planning immediately on a bilateral basis and expand emergency planning as quickly as possible to include other major petroleum consuming countries." We believe it would be desirable that there be multilateral participation (including producers) from the initial stage. If other countries will not participate, Japan and the United States, as the two largest consuming countries, should take the leadership and proceed themselves on what hopefully would become a multilateral effort. Such plans, of course, would have to respect fully both countries' IEA or other international commitments.

The American officials with whom we met appeared confident that the present IEA sharing arrangements are adequate. They pointed out that the United States is increasing its stocks of petroleum. Another view expressed was that shortages could be managed through market forces or voluntary conservation. Japanese government officials, on an informal basis, suggested that a supply crisis in the range of 15-20%

reduction in oil exports would create "chaos." The implication was that it would be impossible for present international arrangements to cope with a shortfall of this magnitude.

It is precisely because of the potential for chaos that we believe it would be irresponsible for leading governments to fail to discuss crisis scenarios and engage in contingency planning.

A shortfall of 20% in oil imports over a prolonged period would create essentially wartime conditions for both the American and the Japanese economies. One cannot rely on the price mechanism or voluntary arrangements with private companies to effectively ration supplies. Nor is international energy sharing among the IEA countries the only possible response. Depending upon the kind of contingency and the outlook for its duration, diplomatic and military instruments might be required. Under what circumstances might the United States intervene militarily? In those cases, would Japan lend its political and diplomatic support for U.S. actions or would Japan try to dissociate itself from the United States? These are clearly questions the two governments should be discussing insofar as possible in advance.

It should be noted that a major purpose of contingency planning is to give governments a better chance of making rational decisions at a time when the dangers of chaos are all too real. As previous energy supply crises have shown, there are tremendous pressures on governments to take hasty, unilateral measures. If governments can refer to prior careful planning and some international understandings, it can help give reassurance to domestic publics that the governments are able to deal with the situation. This will strengthen the probability of constructive national reactions by consuming countries.

We continue strongly to urge government energy supply crisis management studies and also believe much useful work can be done in this area by private research organizations and academic institutions on an individual, bilateral, or multilateral consortium basis.

STRATEGIC PETROLEUM RESERVES

Strategic petroleum reserves are an element of consuming countries' oil supply emergency preparedness programs. This is especially important for the United States and Japan, the two largest importers of oil in the world. Both countries have committed themselves in the

International Energy Agency to maintain oil stocks equivalent to at least 90 days of oil imports.

Our January Report noted that larger stockpiles would not only help in coping with a prolonged crisis but would also reduce the initial psychological impact of a large-scale supply interruption. With sufficient stocks, governments and oil companies would be under less political and speculative pressure to bid up spot prices and make long-term commitments. The present oil supply and price situation favors the acquisition of additional stockpiles.

We are encouraged by the U.S. administration's commitment to increase the strategic petroleum reserve to 750 million barrels by the mid to late 1980s. **We recommend that the United States and Japan take the lead among IEA countries in reexamining the adequacy of oil stocks.** Work on this issue is already underway within both countries, and significant benefits can be gained from multilateralization of these efforts. Maintenance of stocks is complicated by such disparate problems as availability and security of stocking facilities, transportation links between those facilities and consuming markets, and financing. International cooperation may help to solve these problems.

ALASKAN OIL SWAP

In January, we recommended that there be legislative or policy changes in the United States to permit the sale of Alaskan oil to Japan in exchange for other oil already committed to Japan. In our judgment, removal of the current prohibition would have an important symbolic effect on American-Japanese relations, give credibility to the concept of petroleum-sharing, help reduce the bilateral imbalance of trade, and represent a more efficient and less expensive use of Alaskan oil by reducing transportation costs.

The formal U.S. government position, communicated to us, is that "while we expect to review this issue, no decision has been made to seek new legislation." A considerable amount of time was devoted to discussing this issue with U.S. government officials in our June Washington meeting, and it seemed to be the general consensus that although this recommendation has economic merit, political difficulties remain. These officials indicated that there could be substantial savings in transportation costs, but very little of these savings would be passed on

to the consumer in the short-term. However, oil sales to Japan would serve a useful public interest in that producers could use a substantial portion of the savings for further exploration or retained earnings would go to the treasury through the windfall profits tax. Additional revenue accruing to the U.S. Federal government could be as much as \$500 million.

The political difficulties are of two kinds. First, removal of the prohibition would be opposed by specific U.S. organizations, such as shipping interests and unions which benefit from the current higher cost transportation of Alaskan oil to the East Coast. Second, at a time when the U.S. government is encouraging the conservation of petroleum, it would be difficult to publicly explain the rationale for exporting.

We believe that benefits in terms of transportation savings, government revenues, resources devoted to further exploration, the trade balance, and good international relations can be explained to the American public. The public should also know what the current embargo is costing them.

We recommend the U.S. government prepare a detailed analysis of the costs and benefits of the export ban on Alaskan oil and the effects of lifting it. The administration should be factually prepared to exploit legislative opportunities to permit the sale or swap of Alaskan petroleum to other countries.

In our conversations with American government officials, it was pointed out that petroleum products such as petroleum coke or coal/gas mixtures may be exported with only the removal of regulatory restrictions. We hope that any export obstacles to free trade in these products will be removed.

ALTERNATIVE SOURCES OF ENERGY

Measures such as contingency planning, enlarged petroleum stock-piles, and the more efficient use of Alaskan oil will be helpful in meeting short-term actual or potential energy supply problems. Vulnerability to interruption of imported petroleum supplies will be substantially reduced in the long-term, however, only through the diversification of sources of energy.

Nuclear energy

In our January Report, we gave special attention to nuclear energy and coal as alternative sources of energy. We noted that Japan, in particular, has ambitious plans for increasing the use of nuclear power. This is rational because nuclear energy will provide Japan with a major source that is least dependent upon other countries. As a supplier of raw materials and plants for nuclear power, however, the United States is vitally important to the success of Japan's nuclear power programs.

As referred to in our earlier report, a major dispute occurred in 1977 when the United States denied Japan material needed for its pilot reprocessing plant at Tokaimura. Eventually, a compromise was reached between the two governments allowing Tokaimura to start up on a limited basis. The United States has taken a realistic approach in the presidential statement of July 1981 on non-proliferation and peaceful nuclear cooperation by promising not to inhibit civil reprocessing and breeder reactor development in countries with advanced nuclear power programs where there is no proliferation risk. On the basis of this statement, new negotiations have begun between the two governments on fuels for the Tokaimura facility and a second proposed reprocessing plant.

We believe that the United States should be supportive of Japan's nuclear power program and be a reliable and consistent supplier of fuels, including those needed for reprocessing facilities.

We again urge both governments to support the rapid development of nuclear energy as a necessary and efficient source of energy.

Coal

In our January Report, we noted that coal offers a particularly attractive basis for reducing dependence on Middle East petroleum supplies, expanding alternative energy sources, and improving the bilateral trade balance. Based on our consultations with government and industry representatives in both countries, we feel that a summary of the issues involved in expanding bilateral trade in steam coal and recommendations for encouraging this development is useful.

The United States has the world's largest coal reserves. As part of Japan's energy diversification program, Japan will be using increasing

amounts of steam coal for the generation of electricity and industrial use. Coal ports are being planned and developed in Japan. Similar expansion of mining, transportation, and port facilities is being planned in the United States. Research and development efforts in beneficiation, transportation, combustion, and emission control technologies are increasing in both countries.

While these recent developments suggest an expansion of mutually beneficial bilateral trade in steam coal, there are a number of constraints.

First, most U.S. coal is more expensive than coal from Australia, currently Japan's dominant supplier. Shorter inland transportation distances give Australian coal a cost advantage and, therefore, Australia is likely to continue to be Japan's preferred supplier. The desire of Japanese utilities and industry for greater diversification of sources of supply may offset to some extent relative price differentials and give the United States a strong position as a second supplier. In this regard, the Advisory Committee on Overseas Coal of the Energy Agency of Japan recently recommended that Japan diversify its sources of supply and referred to the United States as an important alternative source.

Second, the U.S. government has made it clear that it does not intend to subsidize coal mining, transportation, and exports, but it will seek to remove regulatory impediments to expansion of coal production and trade, and facilitate the improvement of harbors. With U.S. government policy thus clearly established, it is the responsibility of the private sector to develop this trade.

Third, the mining, processing, transportation, combustion, and storage of coal create environmental problems. These problems cannot safely be resolved by a simplification or streamlining of environmental regulations. The private sectors will have to invest in research and development in safe coal technologies, and this will require both time and considerable expenditure.

Fourth, the expansion of Japanese and U.S. steam coal utilization requires the commercialization of the best available beneficiation, transportation, combustion, and emissions control technologies. Joint commitments to develop existing technologies on a commercial scale would facilitate the investments necessary in both countries.

Fifth, there are transportation bottlenecks in both countries to be overcome. U.S. port facilities for coal are being expanded, yet the requisite dredging of U.S. West Coast and Gulf Coast harbors remains a

barrier to export expansion. This is a governmental responsibility.

Sixth, uncertainty of future demand and delays in construction of storage and generating capacity create risks for individual Japanese utilities in making major long-term purchase commitments. Japanese trading companies and the Japanese government have not, as yet, agreed to share this risk.

Despite these constraints, we believe that there is potential for a major expansion of U.S. coal exports to Japan over the next decade. We are encouraged by the growing interest of the private sector organizations in both countries in the coal trade. **We believe expanded U.S. steam coal exports can significantly help alleviate both energy and bilateral trade problems, and we strongly urge the private sectors to accelerate their efforts to develop this trade.**

The private sectors of both nations should expand information exchanges through fora such as the Western States Governors Policy Office (WESTPO) and the Japan Coal Development Company. The U.S. coal industry should continue to provide information as requested by the major buyers of coal in Japan and press toward consummation of supply contracts. It should concentrate on developing procedures within each step of the coal chain designed to assure reliability of steam coal supply in Japan.

CHAPTER V

Toward a Comprehensive Partnership

In our January Report, we called for a comprehensive Japan-U.S. partnership based on three principles — that the relationship involves not only bilateral and reciprocal obligations but also shared responsibilities for the management of the international economic and political order, that Japan needs to develop and articulate a more active international role, and that the United States must better come to grips with the global diffusion of power and the realities of interdependence.

In the introductory chapter of this report, we discussed the reasons why a new Japan-U.S. partnership based on a more equitable sharing of global responsibilities is needed. In the second, third, and fourth chapters, we have examined trade and energy issues where concerted efforts by Japan and the United States to promote liberalized trade and resolve energy supply problems will help consolidate their bilateral relationship as well as contribute to a strengthening of the international order.

In this chapter, we will elaborate on our discussion in the introductory chapter and our January Report on the concept of “shared global responsibilities,” considering briefly a number of additional areas where a close Japan-U.S. partnership can be valuable in promoting both countries’ interests in a more prosperous and peaceful world. These areas include the two countries’ relationships with the other industrialized democracies in Europe, with the Soviet Union, and with the developing world.

Relationships with third countries and approaches to global problems are already an important part of the bilateral Japan-U.S. economic relationship. These issues, of course, are characterized by a close

intermingling of economic and political elements and necessarily so. Maintenance of a healthy international economic system requires a stable international political order. Maintenance of a stable international political order requires certain kinds of economic as well as political actions by the United States and Japan. It is impossible, therefore, to consider the bilateral economic relationship in isolation from a larger context that involves the two countries' international economic and political responsibilities.

At the outset, several points should be kept in mind.

First, the sharing of global responsibilities does not imply that the two countries should have or aim to have identical policies toward each issue or region. This would be an unrealistic goal, and it is not necessarily a desirable one.

It is unrealistic because although Japan and the United States share broadly similar fundamental values and interests, differences in economic, geographical, and political situations do lead to differences in interests or the perception of interests in some situations. Moreover, such factors as historical experience and culture can lead to differences in approaches, even when ultimate goals may be quite similar.

It is not necessarily desirable to have identical policies because a diversity of approaches can permit valuable experimentation or complementary actions. Moreover, identical policies can lead to a misperception that the United States and Japan are seeking to dominate third countries.

Because the United States and Japan have basically similar interests and values, we believe that there should be frequent consultations on global issues to maximize cooperation and avoid misunderstandings where approaches differ. What is needed is a willingness by both countries to consult fully and to be able clearly to articulate their policies and the rationale behind those policies. Each needs to be cognizant of the interests and sensitivities of the other country and to take that into consideration in its own policymaking process. Even where joint or explicitly complementary policies cannot be agreed upon, U.S. and Japanese policymakers should strive not to undermine or appear to undermine the policy of the other country.

Second, the respective policies of the United States and Japan toward international economic issues or third countries and regions are highly interdependent in the sense that each country's policy affects the policy of the other country. U.S. trade sanctions, for instance, as in

the recent cases of Iran and the Soviet Union, can be made more or less effective depending on the degree of Japanese cooperation. Japan's willingness to provide foreign assistance and support multilateral financial institutions depends to a degree on continued American support for such programs and institutions. Each country's posture toward North-South negotiations can affect the course of these negotiations and thus the policy requirements of the other country. The sharing of international responsibility often entails financial costs or policies (such as trade liberalization) for which it is difficult to obtain domestic political support. If these policies are presented in Japan and the United States as part of a cooperative, international program with other like-minded countries, this can strengthen their domestic appeal.

Third, many of these issues, such as North-South relations and relations with the Soviet Union, are politically highly visible. For this reason, the degree of cooperation or divergence between Japan and the United States can attract a high degree of media, public, and high level official attention. Japanese are very concerned about the U.S. policies toward the Soviet Union and toward the developing world because these involve such critical questions as war or peace and resource availability. An American mistake could be very costly to Japan. Similarly, because relations with the Soviet Union, or issues like the Iranian hostage question, are very important to Americans, they have high expectations of cooperation by allies. Therefore, issues involving relations with third countries can become important in U.S.-Japan relations, either as demonstrations of solidarity or as potential sources of conflict.

RELATIONS WITH WESTERN EUROPE

The countries of Western Europe share common values and interests with Japan and the United States and share responsibilities for maintaining and strengthening the international order. The United States and Japan should seek to maximize Western European participation in constructive forms of international cooperation on an equal basis. This is particularly true at the present time when there are signs that the countries of the European Economic Community are becoming more inward-looking as a result of strains caused by slow growth, high unemployment and inflation rates, and different approaches to eco-

conomic and political issues preferred by individual governments in the Community. Many observers believe the appeal of protectionism is far higher in some European countries than anywhere else in the industrialized world.

Increased introspection on the part of the Western Europeans could encourage some Americans and Japanese to advocate bilateral approaches to world problems, leaving Western Europe out. While we believe that Japan and the United States should expand their bilateral cooperation and consultation on a broad range of issues, this should not be done at the expense of either country's relationship with the countries of Western Europe. **We believe that institutional mechanisms for dealing with serious trade issues between Japan, the United States, and Western Europe need to be reviewed and strengthened.**

European integration has generally stimulated European development and in most instances, has been trade creating. (One major exception has been the Common Agricultural Policy, which has prevented meaningful multilateral trade liberalization in agriculture.) **While the ultimate success of the European Economic Community is in the hands of the Europeans, we believe that Japan and the United States should continue policies in support of European integration and work closely with the Community institutions wherever feasible.**

RELATIONS WITH THE SOVIET UNION

We are generally pleased by the high degree of cooperation demonstrated in the recent past in U.S. and Japanese policies toward the Soviet Union. Both countries strongly deplored Soviet intervention in Afghanistan and took similar steps in boycotting the Moscow Olympics, limiting personnel exchanges with the Soviet Union, and restricting trade to demonstrate the seriousness of their concern.

We are concerned, however, by strong political and bureaucratic pressures in the United States to formulate its policies toward the Soviet Union unilaterally. The Olympic boycott, the partial embargo on grain sales to the Soviet Union, and the lifting of that embargo were decisions made in Washington with a minimum of consultations with allies. As we stated in our January Report, allies cannot be expected to cooperate fully with American policy decisions unless they have been fully consulted in advance and allowed to participate in the formula-

tion of alliance goals and policies.

On Japan's part, there has been a tendency for Japan to react to American policy initiatives rather than to contribute positively to the development of alliance policy formulation. Japan, however, is beginning to play a more active role, and we hope that this trend will continue.

We believe that policies toward the Soviet Union and Eastern European countries require close consultation and collaboration among the principal partners of the free and democratic world, and we are pleased that this has been evolving in the context of the economic summits.

NORTH-SOUTH ISSUES

North-South relations occupy a very large part of the international economic diplomacy of the advanced nations. Almost a third of the 1981 Ottawa Declaration was devoted to this subject. In October 1981, a summit conference on North-South issues will be held in Cancun, Mexico, and the industrialized countries have agreed to a later global development conference.

Both Japan and the United States have a very large stake in the economic development and political stability of the developing world. In calendar year 1980, developing countries (excluding China) provided 60% of Japan's imports and purchased 46% of Japan's exports. The developing world as a whole represents for Japan a market almost twice the size of Japan's American market. For the United States, developing countries provided 47% of U.S. imports and took 31% of U.S. exports. The value of U.S. exports to the developing world exceeds by more than three and a half times U.S. exports to Japan. Moreover, the developing countries represent rapidly expanding markets. There is little doubt that their continuing strong demand had a major effect in cushioning the impact of the last recession.

Global economic conditions have made parts of the developing world more vulnerable to political, economic, and social instability. A major task of the industrialized countries is to assist the developing countries in overcoming these challenges while integrating them more fully into the international economic order. This entails several responsibilities: first, Japan and the United States, and their OECD partners, should provide trade opportunities and investment capital for the developing countries through liberal access to their markets, capital,

and technology. Second, effective foreign assistance programs are needed to help developing countries improve their economic performance while maintaining political stability. Third, concomitantly with their development, the developing (particularly newly industrializing) countries will want to play a greater role in helping shape the basic rules and institutions of the international economic system. It is important that they have such a role. At the same time, with their economic progress, these countries should progressively assume the full responsibilities of developed members of the international economic system.

Trade Relationships

In chapter II, we discussed the importance for Japanese and American national interests of free trade policies. Unfortunately, the tariff structures of both countries favor the import of raw materials and unprocessed goods, but provide higher protection against processed and manufactured goods. This tariff escalation tends to discriminate against the manufactures of both developing and other developed countries. **We urge the governments of our two countries to make greater efforts to reduce the bias in their tariff structures against the importation of products important to the economic development of developing countries.**

Japan, the United States, the European Economic Community, and several other advanced countries provide GSP (generalized system of preference) tariff treatment for products of developing countries. These systems are designed to stimulate exports, enhance opportunities for developing countries to diversify their economies, and reduce their dependence on foreign aid. The systems differ in several respects, for instance, the number of countries eligible for GSP treatment, the products covered, the way the programs are administered, and the ceilings on the value of goods that can be imported on a preferential basis. While the value of GSP has been reduced as tariff levels generally decrease, studies have shown that it does contribute to the economic growth of recipient countries.

In April 1981, Japan agreed to extend GSP tariff treatment for another ten year period. The European Economic Community has committed itself to providing preferences through the end of this century. The U.S. system lacks legislative authority to continue beyond 1984.

We believe the United States should continue to provide GSP tariff treatment for developing countries as part of its international commitment to economic development. Preparations for a renewal of legislative authority, including review of the Japanese and EEC systems and a study of appropriate means of “graduating” (or phasing out of the system) more advanced developing countries who no longer require differential treatment, should be begun in the United States. We are concerned about the lack of political support for this program. Its value to the United States and role in American international obligations need to be better explained to the public, labor, and business communities.

Japan and the United States should consult with each other and with other developed countries on means of simplifying administrative burdens of their GSP programs, maximizing uniformity among their systems, and in providing a better distribution of benefits among the developing countries.

Foreign Assistance Programs

Our January Report recommended increased foreign assistance commitments by both the United States and Japan. Because of Japan’s lower military security burden, we recommended that Japan substantially increase its economic cooperation programs as a contribution to the comprehensive security of free world political and economic institutions.

Foreign assistance programs in both countries have lacked strong popular and political support, and in the United States, especially, foreign assistance has been the target of budget reductions. We believe that both governments need to better articulate and publicize their national and mutual interests in maintaining strong and effective foreign assistance programs. These programs are not one-way “give-aways” that benefit only the recipient countries. They not only serve humanitarian objectives, but may generate mutually beneficial economic and political relationships, contribute to the strategic objectives of the free world, and help the long-term expansion of markets for both donors and recipients.

We are particularly concerned about the level and focus of U.S. foreign assistance efforts. U.S. “Official Development Assistance”

[ODA]* is now only 0.20% of its gross national product, third lowest among the advanced aid-donor countries. The argument is frequently made in the United States that current economic problems prevent giving as large a proportion of foreign assistance as in the past. Yet when U.S. GNP was much smaller, a higher proportion of it was devoted to aid. As real wealth has increased in the United States, aid as a percentage of GNP has declined.

There have been delays in the United States meeting the commitments it has made to international financial institutions. Under internationally agreed upon cost-sharing arrangements, such postponements can also delay or prevent support promised by other governments. It is in the U.S. interest to maintain its support for multilateral lending agencies such as the World Bank and regional development banks, many of which were created as a result of American policy initiatives. As multilateral undertakings, these banks provide far more in foreign assistance resources to developing countries than the United States could provide bilaterally. Moreover, by borrowing in private capital markets, they leverage relatively small amounts of donor country paid-in subscriptions into much larger contributions to economic assistance.

In the case of Japan, official development assistance reached 0.32% of Japan's GNP in 1980, a figure that is still below the average of Development Assistance Committee (DAC) countries but much higher than in previous years. Japan's aid has increased substantially in recent years, from \$458 million in 1970 to \$3.3 billion in 1980. Furthermore, Japan has pledged to increase its aid disbursements in the 1981 to 1985 period to twice the level in the 1976 to 1980 period, entailing an average annual increase of about 11%.

While the quantity of Japanese aid has increased at a rapid rate, the quality of this aid remains the lowest of OECD donor countries on these two important indices. The grant element of Japan's ODA was 74% in 1980, compared to the DAC members' average of 90%. The ratio of grants to credits was 40% compared to the average of 76%. Japan needs to make more concerted efforts to improve its performance on these criteria.

Japan will provide more than \$21 billion in developmental assist-

* Official Development Assistance consists of net disbursements of loans and grants made at concessional financial terms by official agencies with the objective of promoting economic development and welfare in developing countries.

ance over the next five years. We recommend that concomitantly with this expansion, Japan review and study its aid programs to maximize their effectiveness in strengthening Japan's contribution to the economic and political vitality of developing countries. Such a review should encompass the quality of its assistance, the adequacy of program evaluation, the best possible means of administering the programs, and their public rationale.

In contrast to the United States, there is virtually no Japanese private assistance flowing to developing countries. In the United States, private charities are supported by allowing tax deductions for contributions and joint government-voluntary organization programs. **In our January Report, we recommended that Japan should provide support through the tax system for private, non-profit organizations engaged in international activities. We reaffirm this recommendation.**

China

The People's Republic of China is a developing country. Both the American and Japanese governments recognize an interest in assisting China's economic development and in promoting increased Chinese participation in international and regional economic institutions.

We believe that both governments and their private sectors should continue to strengthen their trade and investment relationships with China on a sound business basis. China's contacts with Japan and the West have been very limited until the 1970s. The Chinese have much to learn about generally accepted management, business, trade, and investment practices in market-oriented economies, just as nationals of the advanced industrial countries have much to learn about China's economic situation, resource base, growth prospects, and philosophy of economic development.

At this stage, policy-oriented dialogue between China, Japan, and the United States and educational exchange can be very valuable in promoting mutual recognition of each other's societies and interests. **We urge the Japanese and American governments and private sectors to continue to encourage the growth of such exchanges with China.**

The Pacific Basin

The Pacific Basin is a region of high economic growth. Japan and

the United States can be proud of the roles they have played and are playing as the principal trading partners and providers of external capital to this region.

With growth has come increased interdependence and some calls for the establishment of a regional inter-governmental institution for consultation on Pacific Basin economic issues. The question of such an institution raises complex political issues, such as whether or not the institution should be limited to market-oriented countries or include some or all non-market countries bordering on the Pacific.

Although a new, pan-Pacific inter-governmental organization is not currently feasible, the issues of regional economic interdependence are real and are not being addressed very effectively in existing international institutions or bilaterally. For this reason, we believe there should be continued exploration of these issues on a private basis with informal governmental participation.

SECURITY

In our January Report, we recommended that Japan “clarify its defense role, strengthen its self-defense capabilities, and shoulder a more equitable burden with the United States in attaining comprehensive security.”

Japan has been making steady progress along these lines, but much remains to be accomplished. In particular, we hope that the Japanese government will seek to fulfill as early as possible the goals of the National Defense Program Outline, which was adopted by the cabinet in 1976. As we have already noted (see p. 8). Japan has also committed itself to alleviating further the financial burden on the United States in maintaining its forces in Japan and we hope concrete measures will be taken expeditiously. It is our understanding that these efforts will be viewed by the Japanese government as an integral part of its contributions to “comprehensive security,” which also include political and economic contributions.

The achievement of Japan’s security goals requires the development in Japan of a political consensus on Japan’s defense needs and the nature of its contributions to the security of the free world. In bilateral discussions of security issues, the United States should be careful in presenting its views so as not to endanger this delicate and essentially

domestic consensus-building process. Particularly, if the United States government suggests specific numbers and kinds of defense procurement or spending levels, this can be construed as “American demands,” creating a debate on the appropriateness of this kind of pressure and diverting the attention of the Japanese public and political leadership from more fundamental issues of Japan’s security environment and needs.

Both countries need to be realistic about different perceptions of world and East Asian security threats held by the political majorities in their respective countries and other countries in East Asia. With intensified dialogue on security issues, these gaps may close, but in the absence of dramatic external events, this is likely to be a slow, step-by-step process.

The United States needs to recognize better the valuable contribution Japan has been and is making to the security of the free world. Japan’s economic growth has had a very powerful effect on economies throughout East Asia, greatly strengthening the resiliency of non-communist nations in the region. Many Asian nations believe that this is the best kind of contribution Japan can make to their security.

At the present time, there is in Japan insufficient public awareness of and appreciation for the contribution that the United States and its military forces are making to peace and stability in East Asia and the world. While Japan is benefiting from this environment, The United States is assuming a disproportionate share of the financial and political costs for its maintenance. We hope that there will be greater public recognition of this and of the indispensable role that the U.S.-Japan Security Treaty and the two countries’ defense cooperation plays in sustaining the security environment in East Asia.

Conclusion

With the publication of this report, the work of our Group will cease. This work, however, does not become irrelevant. Far from it. If we have done our job properly, our reports and recommendations should be focal point for discussion and dialogue for a considerable time to come. This raises the question of appropriate follow-up.

It is very important that there be continuing follow-up. We believe, as we stated in our January Report, that the Japan-U.S. economic and political relationship is basically healthy. But we also believe that its continued, long-term health requires the careful addressing of numerous problems, such as creeping protectionism and failure to fully implement free market policies, outmoded or erroneous perceptions of the other country, unresolved energy issues, the politicization of economic disputes, and the failure to find truly effective means of consulting and working together on some bilateral and global problems. In an increasingly interdependent world, the relationship between the two largest national economies cannot be neglected. The governments and the private sectors of both countries need to actively foster those conditions which will lead to an even closer, mutually beneficial partnership.

This task, of course, has been at the heart of our efforts. Our Group, however, has been a private advisory body, purposely separated from the exigencies of day-to-day policymaking. It was our mandate to review the economic relationship in longer-term perspective and make general recommendations to improve it. It is the much more difficult task of others to translate these into concrete policies.

As was proper for a group established by the Prime Minister and the President to report to them, our recommendations were primarily

addressed to governments. Such matters as energy supply contingency planning, enhanced avenues for intergovernmental consultations, the establishment of a Japanese trade ombudsman's office, and qualitative improvements in foreign assistance programs, for example, are recommendations whose implementation requires the initiative of one or both governments.

To ensure continued governmental attention to these issues, we recommend that both governments retain and utilize interagency mechanisms on a regular basis. These interagency task forces should have the continuing function to review the kinds of issues addressed in our reports, interacting with private sector groups involved in Japan-U.S. economic relations, and periodically monitoring the overall progress in strengthening the relationship.

Other of our recommendations require implementation by the private sector or through cooperation between the private and public sectors. In the areas of exchanges of information on productivity improving and energy savings technologies, trade law problems, and the identification of future trade issues in Japan-U.S. economic relations, the private sectors will play the key role in implementation. We are pleased that in June 1981, the Japan-U.S. Businessmen's Conference discussed our report and considered means in which the private sector can aid in implementation. We look forward to working with the Conference on an individual basis. Other private sector organizations, such as research institutes, will also need to play a role in following-up on our recommendations for policy studies and exchange programs.

One of the reasons we believe our work has been a success is that it has involved intensive dialogue on difficult issues in Japan-U.S. relations. In any cross-cultural context, the resolution of such issues requires a long process of developing a better understanding of their factual background and a narrowing of what often are quite different perceptions on different sides. Unless there is continuous follow-up and study between meetings by smaller groups, annual meetings cannot hope to make much progress in narrowing such gaps. **We believe that an intensified program of discussion and study through such organizations as the Japan-U.S. Businessmen's Conference can significantly accelerate the process of consensus building on issues affecting the private sectors.**

Aside from further dialogue on the issues we have raised, we believe there needs to be a broad, periodic review of Japan-U.S. economic relations from a more detached, longer-range perspective. The

kind of large-scale, comprehensive exercise in which we have been engaged is unique and would lose its value if placed on a continuous basis. However, there is a need for both the governments and interested private sector groups to monitor regularly the relationship from a longer-term viewpoint, reviewing trade barriers, assessing general trends and identifying future issues for more intensive work.

Perhaps the most important single prescription for the longer-term health of Japan-U.S. relations is to continue to bear in mind the fundamental benefits of close working, trading and political relations for both countries. Japan and the United States have a partnership because it is in the national interests of both countries to be partners. Each enhances its own prosperity and security through its association with the other. Both have fundamentally similar interests in preserving a free trade system and a stable international political system. The overriding importance of these shared benefits and interests should never be allowed to be overwhelmed by the periodic conflicts of specific interests that are inherent in the relations of any two large and industrially competitive nations.

APPENDIX 1

Excerpt on the Japan-United States Economic Relations Group from the Joint Communique between President Ronald Reagan and Prime Minister Zenko Suzuki, 8 May 1981.

The President and the Prime Minister highly valued the report of the Japan-United States Economic Relations Group which contains recommendations that will contribute to the long-term development of the Japan-United States economic relations. They agreed that the two governments should address the various recommendations for possible implementation. They also expressed the hope that the recommendations would be studied in such fora as the Japan-U.S. Businessmen's Conference.

APPENDIX 2

Press Release on the Japan-United States Economic Relations Group issued at the time of the Japan-U.S. Sub-Cabinet Consultations, 15 September 1981.

The Governments of Japan and the United States express appreciation to the members of the Japan-United States Economic Relations Group for the positive contribution they have made to U.S.-Japan economic relations through their thoughtful insights. The two Governments have separately and jointly conducted a detailed study of the Group's report and recommendations which have already done much to improve understanding and the quality of the dialogue between the United States and Japan. During the visit of Prime Minister Suzuki to the United States last May, President Reagan and Prime Minister Suzuki agreed that the report contains recommendations that will contribute to the long-term positive development of United States-Japan economic relations.

The Governments of Japan and the United States are in substantial agreement with the principles of liberalized market access, an open world trading system, positive adjustment to international competition and strong domestic economies, which form the basis upon which the Report's recommendations are based.

Both Governments acknowledge the need to promote mutual understanding through U.S.-Japanese consultations at various levels. They further share the view that these consultations should encompass such topics as macroeconomic policies, agriculture, and energy. The consultative mechanisms have been strengthened by agreement to hold the Subcabinet economic consultations on a semi-annual basis and by the establishment of a Trade Subcommittee of the Subcabinet group. Consultations on specific business problems, as undertaken, for example, in the strengthened Trade Facilitation Committee are also helpful.

The Governments shared the view that expanded programs of exchange for parliamentary and increased training of experts on each country are effective means of improving U.S.-Japan understanding.

Concerning United States-Japan relations in the energy area, the energy area, the Governments of Japan and the United States share the view with the Wisemen on the critical importance of the world energy situation. They will continue their individual and collective efforts to reduce dependency on imported oil, and encourage increased production and use of other energy sources. Both Governments reaffirmed their commitment to close international cooperation in the International Energy Agency.

The Wisemen expressed appreciation for Japan's trade liberalization efforts in both agricultural and manufactured goods and urged that further liberalization steps be taken. The Government of Japan will give careful attention to these recommendations. Both Governments share the view on the need to expand trade, particularly in manufactured products. The implementation of Minister Tanaka's July 14 statement that Japan intends to increase imports of manufactures will help this mutual effort. In this connection, it is also recognized that stronger efforts by U.S. exporters in seeking access to the Japanese market were desirable.

The Report also contains several recommendations for the United States to implement on its own initiative. Foremost among these is that the President make productivity a major focus of United States

economic policy and that the United States Government adopt policies that foster a non-inflationary, stable economic climate conducive to investment and improved productivity. The Administration and Congress are highly sympathetic to this approach and are addressing many of the specific recommendations in a comprehensive economic recovery program that emphasizes stable policies, tax reform, regulatory reform and productivity growth. The U.S. is also studying the recommendation that government funding for the Trade Study Group be provided.

Many of the Group's recommendations relate to actions that the United States private sector should take to improve its competitiveness in world markets. The Governments note that the Wisemen also addressed recommendations to the private sectors of both countries. The Governments encourage the Japan-U.S. Businessmen's Council and other private sector organizations to help implement these recommendations.

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